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T H E BROOKINGS R E V I E W

Charles L. Schultze on Industrial Policy:

"We actually know precious little about identifying, before the fact, a 'winning' industrial structure."

Alice Rivlin on the Budget:

"The question is: Do we really need all the things that we're buying?"

Plus:

James L. Sundquist on the Legislative Veto

*Robert W. Crandall and R. Shep Melnick
on Reform of the Clean Air Act*

A Roundtable Discussion on Unemployment

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T H E
BROOKINGS
R E V I E W

Fall 1983, Vol. 2, No. 1

3 Industrial Policy: A Dissent

Charles L. Schultze

13 The Legislative Veto: A Bounced Check

James L. Sundquist

The Political Atmosphere

17 Clean Air and Regional Protectionism

Robert W. Crandall

21 Deadlines, Common Sense, and Cynicism

R. Shep Melnick

25 Interview: Alice Rivlin on the Budget

28 Roundtable: Unemployment

Martin Neil Baily, Gary Burtless, Malcom R. Lovell, Jr., and Roger D. Semerad

32 New Publications

Robert W. Hartman on compensation of federal employees. Andrew S. Carron on the thrift industry.

34 At Brookings

The Brookings Council. A conference on economic relations between the United States and Japan. A dialogue between scholars and executives.

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Industrial Policy: A Dissent

Charles L. Schultze

THE LAST TEN YEARS have been a time of troubles for most of the world's industrial economies. The growth of output and productivity has slowed. Both inflation and unemployment have averaged substantially higher than in earlier postwar years. And the decade has produced the two worst recessions of the postwar period.

In the United States, this experience has spawned two new economic doctrines, each purporting to explain the source of at least some of our economic ills and offering a plan of action to deal with them. These economic theories originated outside of the mainstream of professional economic thought. The first of them is supply-side economics, which is based on a vast exaggeration of the incentive effects of lower taxes. It has had a spectacular political success, and was installed in early 1981 as official U.S. government policy.

The second of these new theories—and the latest entry in the competition for the hearts and minds of political candidates—is a set of economic ideas and policy recommendations that goes by the name “industrial policy.” It has been the subject of a growing stream of books and articles; it has been endorsed as a concept by the AFL-CIO; its precepts have been incorporated in a number of bills now before the Congress; and it is receiving a sympathetic hearing from many of the candidates for the 1984 Democratic presidential nomination.

The phrase “industrial policy” means somewhat different things to different people; it refers not so much to a single theory as to a loose collection of similar diagnoses and proposals. The diagnoses generally cluster around two basic propositions:

First, the United States has been “de-industrializing.” The share of national output generated by manufacturing has been falling in recent years while the share attributable to services has been growing. Within manufacturing a number of essential heavy industries are in absolute decline, and the United States is no longer at the cutting edge of technological advance in the newer, high-tech industries. We are becoming increasingly uncompetitive in world markets. These are the symptoms of deep-seated structural problems; they will not be cured by macroeconomic measures aimed at overall economic growth. The private market is not directing investment to the right places; older manufacturing industries cannot find the funds they need to rehabilitate themselves, and promising new firms in the advancing sectors are often unable to secure as much venture capital as they need for growth. American labor finds it difficult to make the necessary transition from older, declining industries to newer ones with good growth potential and high value-added per worker; this is partly because investment is being directed to the wrong

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industries and partly because laid-off workers do not have the skills needed or are not in the right locations. And when these dislocated workers eventually do get reemployed it is too often in low-skill jobs paying low wages. We are in danger of becoming a nation of hamburger joints and boutique shops.

Second, some other countries—Japan being the preeminent example—have developed governmental policies that successfully promote vigorous industrial growth. The Japanese government identifies potential winners in the competition for world markets and encourages their growth, while simultaneously protecting and easing the burden of adjustment for older but essential heavy industries. Farsighted officials in the Japanese Ministry of International Trade and Industry (MITI), working closely with cooperative Japanese business leaders and bankers, plan and organize, years in advance, such industrial achievements as the penetration of world automobile markets, the development of automated steel mills producing at water's edge for exports, the 256K memory chip, and now the ultimate supercomputer.

The various proponents of industrial policy offer a wide range of suggestions to deal with the structural problems they identify. Many of their proposals involve new or modified federal initiatives in traditional areas: expanded support for technical education; research and development; and programs to retrain workers. Whatever the merits of these ideas, they do not constitute a major new thrust in economic policy. What is new, however, is the proposal that government deliberately set out to plan and create an industrial structure, and a pattern of output and investment, significantly different from what the market would have produced. Two leading advocates of industrial policy, Ira Magaziner and Robert Reich, put the matter this way: "We suggest that U.S. companies and the government develop a coherent and coordinated industrial policy whose aim is to raise the real income of our citizens by improving the patterns of our investments rather than by focusing only on aggregate investment levels."¹

Industrial policy thus aims to channel the flow of private investment towards some firms and industries—and necessarily, therefore, away from others. The government develops, at least in broad outline, an explicit conception of the direction in which industrial structure ought to be evolving, and then adopts a set of tax, loan, trade, regulatory, and other policies to lead economic activity along the desired path.

Industrial policy typically has two aspects—"picking the winners" and "protecting the losers"—and proponents sometimes disagree as to the relative emphasis to be placed on each. "Picking the winners" involves iden-

tifying industries that are at the cutting edge of economic progress, with such characteristics as high growth potential and high value-added per worker, and then providing investment subsidies, research support, and other assistance to existing firms and new entrants in those industries. "Protecting the losers," on the other hand, involves supporting and presumably helping to rehabilitate major declining industries. The government measures that would be deployed for this purpose include creation of barriers against competition from imports, special tax breaks, subsidized loans, and selectively favorable regulatory treatment. In most versions of industrial policy, the government, in a switch from current practice, would require that labor and management in these declining industries accept major reforms—wage restraint, reduction of featherbedding rules, and improved managerial practices—as preconditions for assistance.

In addition to the two explicit propositions noted above—that America has been de-industrializing and that the government of Japan has successfully managed industrial adjustment—there are two *implicit* premises on which the case for a U.S. industrial policy rests. The first of these is that the government has the analytical capability to determine with greater success than market forces what industrial structure is appropriate, who the potential winners are, which of the losers should be saved, and how they should be restructured. The second is that the American political system would (or could) make such critical choices among firms, individuals, and regions on the

basis of economic criteria rather than political pressures.

In fact, as we shall see, reality does not square with any of the four premises on which the advocates of industrial policy rest their case. America is *not* de-industrializing. Japan does *not* owe its industrial success to its industrial policy. Government is *not* able to devise a "winning" industrial structure. Finally, it is *not* possible in the American political system to pick and choose among individual firms and regions in the substantive, efficiency-driven way envisaged by advocates of industrial policy.

De-industrialization: A Nonexistent Trend

America has not been de-industrializing. Throughout the industrial world, economic performance in the 1970s did fall behind the record of the 1960s. But relative to the industries of other countries, American industry performed quite well by almost all standards.²

During the decade of the 1970s, before the current recession began, the United States was vastly superior to the major European countries and to Japan in the



Robert Wiser

generation of new jobs. Total employment grew by 24 percent in the United States during that decade. The next best performer was Japan, with a 9 percent increase. Other countries were far behind; in Germany, for example, employment actually fell. Moreover, the United States was one of only three major industrial countries—Italy and Canada having been the others—with any increase in *manufacturing* employment. According to OECD data, manufacturing production in the United States, while rising less rapidly than production in Japan, grew faster than the European average and outstripped the gains made in Germany, a country that is usually mentioned, along with Japan, as a leading example of industrial strength.³

Manufacturing production in the United States typically rises more in business cycle expansions, and falls further in contractions, than does total GNP. After adjustment for this regular cyclical pattern—and contrary to popular impression—the share of private domestic GNP produced by manufacturing industries did not decline significantly in the 1970s.⁴ The proportion of total U.S. employment accounted for by manufacturing has been falling throughout the postwar period, but this principally reflects the fact that productivity growth (output per person) has continued to grow faster in manufacturing than in most other parts of the economy.

The relatively good performance of the industrial sector in the 1970s was partly due to a very large increase during the decade—in fact, a doubling—in exports of American manufactured goods. This was a good bit less than the rise in Japanese exports, but substantially higher than the increase experienced by Europe. America's export strength was aided by a decline in the real exchange value of the dollar, from an overvalued level at the beginning of the decade to what many people believed was a somewhat undervalued level at the end. Since it is unlikely that the value of the dollar will fall steadily over the long run, the share of U.S. economic activity accounted for by the manufacturing sector could conceivably decline very slowly. That would be a natural development, however, in no way reflecting a structural malaise requiring new governmental policies.

The United States does have some old-line heavy industries with deep-seated structural problems—especially the steel and automobile industries. But they are not typical of American industry generally. There is no evidence that in periods of reasonably normal prosperity American labor and capital are incapable of making the gradual transitions that are always required in a dynamic economy, as demand and output shift from older industries to newer ones at the forefront of technological advances.

Indeed, American industry successfully made some important and desirable structural adjustments in the 1970s, even though that was a decade of economic difficulties throughout the world. Thus, Robert Lawrence of Brookings reports that the U.S. international trade *surplus* in the products of high-tech industries grew from \$12 billion in 1972 to \$40 billion in 1979, while the trade *deficit* in other manufactured products rose from \$15 billion to \$35 billion over the same period. Yet, according to a study done for the National Commission for Employment Policy, dislocated workers—defined as unemployed people whose last jobs were in declining industries and who had been out of work for more than eight weeks—amounted to only 0.4 percent of the labor force in March, 1980.⁵ In addition, although the total unemployment rate was higher in the United

States than in most large European countries as the 1970s drew to a close, long-term unemployment was substantially lower.⁶

But even if it is true that the United States was not de-industrializing in the 1970s, has not the industrial sector performed very much worse than the economy in general during the past several years? Yes, it has. From 1981 through the fourth quarter of 1982—the trough of the recession—GNP declined by 2.2 percent while manufacturing production fell by 10.6 percent. But the outsized drop in manufacturing production occurred for two reasons having nothing to do with de-industrialization. First, as noted above, manufacturing production *always* falls faster than GNP during recessions, and rises faster during booms. In the first

half of 1983, for example, as GNP began to recover at a 5.9 percent annual rate, manufacturing production jumped up at an 16.2 percent rate. Second, the huge rise in the real exchange value of the dollar over the last two years discouraged U.S. exports and encouraged foreign imports—a development that had an especially depressing effect on American manufacturing industries. But the overvaluation of the dollar was obviously not caused by structural deficiencies in American industry; it was principally the result of the combination of tight money and loose budgetary policy that gave us unprecedentedly high interest rates. What is needed is a better mix of macroeconomic policies, not a new government agency to influence the pattern of industrial investment.

What about the dramatic fall in the rate of productivity growth in the United States during the 1970s? Does that not reflect, at least in part, a major structural problem in U.S. manufacturing sector? The pace of productivity growth did, indeed, decrease. While the reasons for this decline are still something of a mystery, a few things are known. First, the decline was worldwide—and its magnitude in the United States was about mid-



Robert Wiser

way down the list of industrial countries. Second, the decline was not concentrated in manufacturing industries; in fact, by most estimates it was somewhat smaller there than in the other sectors of the economy, and productivity growth has continued to be higher in manufacturing than in most sectors. Third, the decline was not caused by a shift in production away from high-productivity manufacturing industries to low-productivity service industries.⁷

Productivity growth is the source of rising living standards. The sharp decline in that growth, in manufacturing and elsewhere, is the most serious long-run problem facing the U.S. economy. But there is no evidence that this decline stems from a tendency for the private market system to allocate investment to the "wrong" places—away from the manufacturing sector or, within manufacturing, to the wrong firms or industries. The decrease in productivity growth in no way bolsters the case for an industrial policy.

A Closer Look at the Japanese Success

The postwar flourishing of Japan's economy is frequently cited as the premier example of how successful an industrial policy can be. The Japanese do have a way of working cooperatively towards national economic objectives without getting strangled in bureaucratic red tape or dulling competition among business firms. But the contributions of MITI and of industrial policy to Japan's postwar success have been far overstated. Other factors were primarily responsible for the phenomenal growth that the Japanese economy enjoyed until very recently.

First, over the past two decades, the Japanese saved and invested some 30 to 35 percent of their GNP, compared to 17 to 20 percent in the United States.⁸ Second, with an industrial plant technologically far behind those of the United States and Western Europe, Japanese business firms were able to put the huge savings to work at moderate risk and with good returns by upgrading their capital stock with known technologies. Countries that were much nearer to the technological frontier, like the United States, had to depend more heavily for their economic growth on the gradual advance of technical knowledge. Third, the Japanese appear to have developed a unique set of cooperative labor-management relationships that promote high quality work and rapid productivity growth.

Throughout the postwar period, the Japanese government in general, and MITI in specific, did act on a broad view of what was required for rapid economic growth in the particular circumstances facing Japan. For example, private savings and investment were encouraged by tax laws and other measures. Up through the early 1970s, macroeconomic policies were highly

expansive, but with a combination of very stimulative monetary policies and large budget surpluses. Thus, the government endeavored to encourage the rapid expansion of both demand and supply. Since it needed to import virtually all of its fuel and raw materials, Japan discouraged the import of manufactured goods. Especially in the earlier part of postwar history, when it was still lagging behind other major countries in industrial technology, Japan protected large segments of its home market against import competition.

But while a broad strategy along these lines did guide Japanese economic policy during the postwar period, that strategy did not dictate the detailed structure of Japanese industry. The major decisions about where funds would be invested were made by Japanese business leaders, not by MITI. Hugh Patrick, professor of Far Eastern economics at Yale, has put forward this assessment:

Indeed, looking at Japanese industrial development as a whole in the postwar period, I think the predominant source of its success was the entrepreneurial vigor of private enterprises that invested a good deal and took a lot of risks. The main role of the government was to provide an accommodating and supportive environment for the market, rather than providing leadership or direction. Unquestionably government planning bodies were important in a few industrial sectors, but not in many others, which flourished on their own.⁹

But the contributions of MITI and of industrial policy to Japan's postwar success have been far overstated. Other factors were primarily responsible

The Japanese government, through its Fiscal Investment and Loan Program (FILP), does control substantial investment sums, amounting in 1980 to some \$80 billion in direct investments, subsidized loans, and loan guarantees. Such a large investment budget does seem to offer potential leverage for carrying out an industrial policy. In fact, however, as Brookings' Philip Trezise carefully documented in the Spring, 1983, issue of the *Review*, the government's investment portfolio is spread across a wide range of enterprises in response to regional, political, and special interest pressures. In 1979, the FILP budget was allocated among some fifty separate agencies, plus a number of local governments. The local governments, together with four agencies (a housing loan corporation, two small business financing entities, and the Japanese National Railways), got a total of 60 percent of the funds. Another 27 percent went to such entities as the Ex-Im Bank; the Japan Highway Corporation; the Japan Housing Corporation; the Agriculture, Forestry, and Fisheries Corporation; and the Japan Development Bank.

The Japan Development Bank (JDB), in turn, seems a likely candidate for the role of financing an industrial

policy aimed at building up major growth industries. The facts belie this conjecture, too. In the first twenty years of the JDB's life, according to Trezise, three-quarters of its funds went to merchant shipping, electric utilities, and regional and urban development. The burgeoning steel industry, on the other hand, received during these two decades less than one percent (\$110 million) of the JDB's financing. Since 1972, in Japan as in the United States, public investment has emphasized energy and pollution control—and the JDB budget reflects this trend. But JDB investment in the development of new technologies outside of the energy industry has averaged only \$313 million a year over the past decade.

Thus, in Japan as in any other democratic country, the public investment budget has been divvied up in response to diverse political pressures. It has not been a major instrument for concentrating investment resources in carefully selected growth industries. Indeed, if one changed the institutional labels, the Japanese government's investment budget looks remarkably like what might have emerged from a House and Senate conference committee on public works in the United States Congress.

All of this is not to suggest that MITI had no influence on the direction of Japanese industrial investment. For example, MITI is widely, and probably quite correctly, cited as having played a major role in organizing the very successful Japanese penetration of the memory chip segment of the world semiconductor markets. As Paul Krugman has pointed out, however, the relevant question is whether this particular use of Japanese savings generated a higher return for the nation than would have been earned had the market allocated the funds.¹⁰ It may have done so, but we do not yet know the answer.

MITI has also had some major failures. For instance, MITI tried very hard—and, as is evident, to no avail—to keep Honda out of the automobile business and to consolidate Japanese auto production into a few giant companies. MITI also attempted to get a major commercial aircraft industry going in Japan, but the banks failed to follow MITI's lead and would not provide the necessary capital. Those who attribute Japan's economic success principally to MITI's industrial policy seem to be suggesting that without MITI the huge 30 to 35 percent of GNP that the Japanese invested in the past several decades would have gone mainly into such industries as textiles, shoes, plastic souvenirs, and fisheries. This is sheer nonsense. Given the quality of Japanese business executives, those massive investment funds probably would have wound up roughly where they actually did. And to the extent that there would have been differences, there is no reason to be-

lieve that MITI's influence, on balance, improved the choices in any major way.

The combination that worked so well for Japan—a huge saving rate, aggressive business leaders, and a backlog of modern technology waiting to be exploited—may now be faltering. In particular, as Japan has caught up to the technological frontier of other Western countries, the potential for large returns from investment in known technologies has been reduced. The propensity to save remains high, but investment opportunities appear to have dwindled. Partly for this reason, Japanese economic growth, while still above that in other advanced countries, fell from an average of 9.9 percent a year between 1960 and 1973 to 3.5 percent a year between 1973 and 1983.¹¹

Identifying the "Right" Industrial Structure

Despite the lack of evidence that the United States has been de-industrializing or that the key to Japan's economic success has been its industrial policy, advocates of an industrial policy for the United States nevertheless propose that the federal government play a much enlarged role in determining the structure of American industry. The centerpiece of an industrial policy is some kind of a development bank—a new Reconstruction Finance Corporation—with authority to do some or all of the following: provide loans, loan guarantees, and subsidies to business firms and regional development bodies; certify firms as being eligible for special tax breaks; recommend measures to protect domestic industries against competition from imports; and negotiate restructuring agreements with labor and management in firms and industries that are in trouble and are candidates for assistance. In many versions of industrial policy, the new RFC would be governed, or at least be advised, by a tripartite body made up of representatives from business, labor, and government. The powers of the Corporation would be exercised in pursuit of explicit industrial objectives designed to achieve some combination of the two broad goals—stimulating the emergence and growth of new high-tech industries and protecting and rehabilitating older industries.

The first problem for the government in carrying out an industrial policy is that we actually know precious little about identifying, before the fact, a "winning" industrial structure. There does not exist a set of economic criteria that determine what gives different countries preeminence in particular lines of business. Nor is it at all clear what the substantive criteria would be for deciding which older industries to protect or restructure.

Originally, comparative advantage and international



Robert Wiser

specialization among countries were thought to derive principally from the relative abundance or scarcity of the factors of production—labor, capital, and various natural resources. The United States and other advanced industrial countries do in fact have a broad advantage in the production of those goods that are research-based and technologically sophisticated, and that require for their production an educated labor force. It is also demonstrably the case that the availability of certain kinds of natural resources can play an important role in determining comparative advantage. But beyond these very broad principles, there are no general criteria that allow one to predict the industries in which a country will be particularly successful.

Advanced industrial countries both export and import a wide range of goods that covers almost the entire spectrum of their manufacturing industries. Exports are not concentrated in one set of selected industries and imports in another. One study has shown, for example, that in major countries very few industries, classified at a medium (three digit) level of detail, had less than 30 percent of their international trade as *intra-industry* trade—i.e., in most categories of industrial goods, international trade involved significant volumes of *both* exports and imports, rather than exclusively one or the other. The distribution among advanced nations of the production of various manufactured products is not principally a function of some broad set of national characteristics, but arises in large part from quite different causes.

In an insightful article on industrial policy, Assar Lindbeck of the University of Stockholm has analyzed the origins of industrial specialization among advanced countries.¹² He argues that what a country will specialize in is determined by a combination of historical coincidence and momentum. Individual entrepreneurs search for a niche in the market. Once one or more firms in a country successfully establish a foothold in the market for some special product, forces come into play that can heighten, at least for a while, that country's comparative advantage in the manufacture of that product. A growing market leads to economies of scale for the original producers. Ancillary firms spring up to supply the new industry's special needs. Workers and managers acquire skills and know-how. Success tends to breed success.

In short, the winners emerge from a very individualistic search process, only loosely governed by broad national advantages in relative labor, capital, or natural resource costs. The competence, knowledge, and specific attributes that go with successful entrepreneurship and export capability are so narrowly defined and so fine-grained that they cannot be assigned to any particular nation. The "winners" come from a highly de-

centralized search process, the results of which cannot be identified on the basis of abstract criteria. As Lindbeck points out, there is nothing in Swedish natural resources or national character that would have foreordained that Sweden would be preeminent in the production of ball bearings, safety matches, cream separators, and automatic lighthouses. Nor, it might be added, is there a basis in observable national characteristics to have predicted Japanese dominance in the motorcycle industry or the American success in pharmaceuticals and the export of construction management and design.

There are, of course, overall policies that government can pursue to create the kind of environment in which a decentralized search process is most likely to be fruitful. What government cannot do—except perhaps in a

country that is far behind the leaders and simply trying to catch up by imitating them—is to identify in advance the particular lines and products in which its country will be successful.

Some have argued that a new industrial policy should particularly seek to reallocate investment towards industries with high value-added per worker and away from those with low value-added. The argument for such a reallocation implicitly assumes (1) that there are large numbers of skilled American workers trapped in low-paying jobs in industries with low value-added per worker; (2) that there are large untapped markets for the products of high value-added industries employing skilled workers; and (3) that this situation exists because of a propensity on the

part of American business to invest too much in the low value-added, and too little in the high value-added, industries. Government policies designed to improve the skills of the labor force make good sense. But given the current mix of skills in the labor pool, there is no evidence that market forces in the United States have tended to ignore potentially large returns in industries with high value-added per worker and to channel excessive investment to those with low value-added. Indeed, as Krugman points out, government redistribution of a fixed aggregate investment from low value-added to high value-added industries would tend to lower employment and output, since capital-labor and capital-output ratios are higher in the latter industries.¹³

There are equally formidable barriers to designing substantively defensible criteria to govern a systematic government policy of trade protection and investment assistance for declining older industries. No one seriously suggests a policy of indiscriminate aid to *all* such industries, so some criteria for choice are necessary. One litmus test that is proposed is the importance of an industry to the national defense; that, however, is al-

In short, the winners emerge from a very individualistic search process, only loosely governed by broad national advantages in relative labor, capital, or natural resource costs.

most always a red herring. The national defense/essential industry argument is usually presented in an all-or-nothing mode, as though, in the absence of import protection, the affected industry would disappear. In fact, what is almost always at stake is a much less dramatic change in the industry's fortunes, of a magnitude that is irrelevant to national defense. Whether, for example, the domestic steel industry meets 80 percent of the nation's peacetime needs, as it does now, or only 60 percent is of no significance to the nation's security.

It has also been suggested that we assist those particular older and troubled industries that other governments are heavily subsidizing. The industries we would end up supporting under this decision rule would most likely be those with worldwide excess capacity, in which the returns to investment are unusually low, since those are the ones most apt to be getting help from other governments. A systematic reallocation of investment away from other American industries towards these would lower the growth of national output and real wages.

Ironically, the systematic provision of import protection to various industries, in an effort to "restructure" them, would indirectly weaken the most dynamic and progressive sector of American industry. Import protection would initially worsen the trade balances of the countries against whom it was directed. As a result, their currencies would tend to depreciate against the dollar. In turn, this would impair the competitive position of American export industries, which, by their very nature, are likely to be at the leading edge of economic progress. We would trade jobs and output in the leading sectors for jobs and output in the losing sectors.

In practice, the motivation behind most existing efforts to protect the losers is not so much to improve economic performance as to lessen the pains of economic change. Almost by definition, a dynamic economy is one in which change is continually at work—change in technology, in tastes, and in world markets. And while change creates new opportunities, it also forces some firms, workers, and communities to make painful adjustments.

A decent concern for the human costs imposed by economic change is one hallmark of a compassionate society. But society can act to reduce those costs in two quite different ways. First, it can short-circuit market forces and try to slow the pace of change through subsidies, trade protection, and regulations designed to prop up declining firms. Second, it can attempt to accommodate and ease the transitions dictated by changing economic conditions through the provision of reasonable unemployment compensation, relocation assistance, and generous training opportunities to

those facing major adjustment problems. Neither approach will fully insulate workers and communities from the pains of economic change. But systematic application of the first approach, while preventing some pain for some people, will over time sap the economy of dynamism and hold down growth in living standards. The second option is far from perfect, but it offers the potential of reducing transition costs with much less impairment of the dynamism that generates economic growth.

Industrial Policy and the American Political System

Not only would it be impossible for the government to pick a winning industrial combination in advance, but its attempt to do so would almost surely inflict much harm.

There are many important tasks that only governments can do—and, with constant effort and watchfulness, they can do those tasks passably well. But the one thing that most democratic political systems—and especially the American one—cannot do well at all is to make critical choices among particular firms, municipalities, or regions, determining cold-bloodedly which shall prosper and which shall not. Yet such choices are precisely the kind that would have to be made—and made explicitly—for an industrial policy to become more than a political pork barrel.

The government can, and continually does, adopt policies that have the indirect consequence of harming particular individuals or groups. But a cardinal principle of

American government is "never be seen to do direct harm." The formal and informal institutions of the political system are designed to hinder government from making hard choices among specific individuals, rewarding some and penalizing others. So it is, for example, that we have an Economic Development Administration, created to help "depressed areas," that has eligibility criteria so broad that they encompass over 80 percent of the counties in the United States. The same pattern—that of obviating the necessity of choice—is evident in the evolution of the Model Cities Program. Two decades ago, planners in the Johnson administration set out to test the proposition that a very comprehensive assistance program—directed at physical capital, education, retraining, social services, and so on—that concentrated large investment in a few areas could overcome the inertial force and vicious cycle of inner city poverty and decay. A demonstration of this approach was initially designed to be carried out in a very limited number of cities; hence the name "Model Cities Program." By the time the concept had made its way through the political thickets of the administration and the Congress, the Model Cities Program encom-

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passed one hundred and fifty cities, each receiving only a fraction of the funding needed.

It is not surprising that the American political system is seldom capable of making express choices among individuals, firms, or regions. The American government, after all, was not established to bring order and authority out of social chaos. Quite to the contrary, it originated in an effort to reduce what was seen as too much authority on the part of the British king and parliament. Its founders were principally concerned to constrain legislative and executive authorities so that they could not make arbitrary and invidious choices among individuals. In the American system, most decisions that discriminate among specific citizens and firms are reached through litigation in the courts, where "fairness," rather than "efficiency," is the major criterion for setting disputes.

When it is necessary to permit executive officials to make such decisions, their exercise of discretion is hedged about by complex procedural safeguards, including the right of appeal to the courts. The Administrative Procedures Act, which governs the exercise of regulatory authority, is a prime example of this approach.

The governmental choices that an industrial policy contemplates have little to do with fairness and much to do, at least ostensibly, with exacting economic criteria. As we have seen, these are precisely the sorts of decisions that the American political system makes very poorly. A new RFC would do no better. For every twenty new entrants into the high-tech race, nineteen will probably perish and only one succeed. But the federal government's portfolio would likely carry all twenty forever.

To be anything more than a universal protector of inefficiency, a systematic program of assistance to declining industries would have to call for some very hard-headed decisions among particular firms, cities, and groups of workers—that the Youngstown plant can live but the Weirton one must close, for example, or that the cotton textile industry has a reasonable chance to rehabilitate itself but the wool textile industry is a hopeless case and must die. Or that in order for the steel industry to compete successfully in world markets, the large increases over the last fifteen years in its wages and fringe benefits relative to those of the rest of industry must be eliminated. Quite apart from the inability of any staff to make such substantive calls correctly, can anyone seriously imagine an American RFC being left alone to make such decisions, with its authorizations and appropriations controlled by the Congress and its policies supervised by a president interested in his own and his party's political success? Rather, we can expect a combination of patterns to

emerge: Some assistance would be made available, on a formula basis, to all industries that were in trouble; the wheels with the loudest squeaks might get a bit of extra financial grease; and protectionist interests would have a new and highly vulnerable pressure point to exploit. In the process, resources would be misallocated, incentives for industrial efficiency reduced, and competitive forces blunted.

The False Allure of "Coordination"

One of the most frequently heard arguments for industrial policy is that it would bring a much-needed coordination to government policy-making. Those who make this argument begin by pointing out that the government already has in place many individual policies that affect the industrial structure, often in illogical, contradictory, or harmful ways. They go on to ask why we do not, therefore, adopt a positive and coherent industrial policy in place of the current ad hoc array. These advocates often cite examples of the foolishness that ad hoc assistance decisions lead to:

- The U.S. government now spends five times more on research and development for commercial fishing than for steel.

- The U.S. tax code provides almost \$750 million a year in tax breaks for the timber industry, but only a small fraction of that amount for semiconductors.

- We now provide substantial import protection for the carbon and specialty steel industries (an illustration presumably adduced on the grounds that with an industrial policy we would be able to extract more competition-oriented reforms from labor and management in the favored industries).

In fact, this argument makes little sense—even if the examples cited are indeed blunders. It might very well be bad policy to spend five times more on R&D for commercial fishing than for steel (although what is relevant is total R&D, private as well as government, and even then it is not self-evident that the payoff from R&D in commercial fishing is less than from R&D in steel). Tax experts long ago concluded that the special treatment of the timber industry was excessively generous. And virtually all economists would argue that the steel protectionist measures are bad for the country. But these conclusions would all be true even if the term "industrial policy" had never been invented, and regardless of whether industrial production was an increasing or a decreasing share of GNP. Indeed, it is curious logic to cite examples of how the American industrial structure has been distorted by political pressures—in support of an argument for entrusting even

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more economic decisions to the same political system. One does not have to be a cynic to forecast that the surest way to multiply unwarranted subsidies and protectionist measures is to legitimize their existence under the rubric of industrial policy. The likely outcome of an industrial policy that encompassed some elements of both "protecting the losers" and "picking the winners" is that the losers would back subsidies for the winners in return for the latter's support on issues of trade protection.¹⁴

The argument is also made that we do provide assistance to individual firms, on occasion and in a very ad hoc way; the Chrysler and Lockheed bailouts are usually cited as examples. Should we not, therefore, regularize and rationalize this procedure, rather than making these assistance decisions on a case-by-case basis? In fact, the ad hoc approach is precisely the right approach. To every rule there are exceptions. It may very occasionally be in the public interest to supersede the market's judgment and to prevent the bankruptcy of some major firm. But it is a virtue that a special law is now needed for each case. It is a virtue that each case is, in fact, treated as an exception. Only very exceptional cases are likely to muster the support needed to enact a special law, and the government's bargaining power, to impose needed and painful reforms on management and labor, is consequently enhanced. Should this process of decision by exception be supplanted by an ongoing authority to initiate bailouts, the result would almost surely be a politically vulnerable fund, available to help avoid or delay politically sensitive plant closings.

Some Real Problems

To say that industrial policy is a dangerous solution for an imaginary problem is not to say that the United States has no serious economic difficulties. It has a number of them.

Our most immediate set of problems is macroeconomic in nature. Recovery from the deepest recession of the postwar period has just begun. Having paid a very high price for partially wringing out a stubborn inflation fifteen years in the making, we—along with every other industrial country—will have to walk a very fine line to sustain an economic recovery vigorous enough to make substantial inroads on unemployment, but not so buoyant as to risk a resurgence of inflationary pressures or inflationary expectations.

In addition, we in the United States face the special problem of a political impasse that threatens to perpetuate very sizeable federal budget deficits even as the economy recovers towards full utilization of its resources. Since the Federal Reserve is most unlikely to

accommodate these high employment deficits with large and inflationary increases in the money supply, failure to break the impasse with tax increases and spending cuts would extend today's high real interest rates—or, more likely, even higher ones—into the indefinite future. This outcome would have particularly serious consequences for the health of America's industrial structure. High interest rates would tend to perpetuate overvaluation of the U.S. dollar, and would continue to penalize American exports and encourage imports. At home, the high interest rates would especially depress purchases of durable manufactured goods. Finally, the ability of new and young enterprises, at the frontiers of technological advance, to raise new capital could be seriously impaired to the extent that the actuality and the expectation of continued high interest rates depressed stock market values.

Getting America's monetary and fiscal policies in order is far more important for the health of the nation's industrial structure than any conceivable set of new industrial policies. What now seem to be serious problems of industrial structure would quickly shrink and become far more manageable with a few years of balanced economic recovery at lower real interest rates.

After the achievement of a sustained and balanced recovery, the prospects for which depend heavily on how the government uses its macroeconomic tools, the next most important factors influencing industrial performance are mainly beyond the government's control—such things as the pace of technological progress, the

course of labor-management relationships, and the stability of world markets. There is, however, a variety of governmental microeconomic policies that can affect, favorably or unfavorably, the vigor and adaptability of American industry. Choices among alternatives in this area sometimes pose very difficult tradeoffs between economic efficiency and other social goals. For example, environmental considerations compete with the objective of keeping industrial costs low. The provision of generous tax incentives for risk bearing has to be balanced with the objective of a more equal distribution of income. Additional federal support for scientific and technical education would conflict with the goal of budget expenditure control. In other cases, what is at issue is not a tradeoff among competing national objectives, but the reform or elimination of provisions in tax or regulatory codes that distort the pattern of investment among different industries. The 1981 liberalization of depreciation allowances, for example, was desirable in the aggregate but very arbitrary as among investments of different types. It sharply skewed rates of return and distorted investment incentives among industries. Determining the federal government's



Robert Wiser

stance on these and other thorny issues will continue to provide grist for the legislative and political mills in the years ahead. How they are settled will have an important, even if not overwhelming, influence on the behavior of American industries.

The most critical and vexing structural problems that American society will have to face in the coming decade have little to do with the issues raised by industrial policy. Even with a return to prosperity, unemployment among America's black youth will remain scandalously high. Large parts of American central cities will continue to be afflicted by serious financial constraints, social problems, and physical decay. And, if recent studies are to be believed, the quality of American education has been deteriorating for a number of years. Unfortunately, no one yet seems to have a very clear idea of exactly how the federal government can best play a constructive role in fundamentally reversing these very troubling structural trends. But we must keep searching for solutions—and where federal outlays are required to experiment with promising approaches, these are the areas, unlike most others, where the benefit of the doubt ought to be given a little more rather than a little less funding.

In sum, there are changes in federal fiscal and monetary policies that could help the economy generally, and industry in particular, attain a more satisfactory level of economic prosperity. There are microeconomic policies that we know could contribute to an environment that is favorable to the creation of new and rapidly expanding lines of business and to the adaptability of American industry. In many cases, formulating these policies requires making some very difficult choices among competing national objectives.

In addition, there are a few very important structural problems for which, at the moment, no convincing solutions are in sight. Yet it is absolutely essential that we keep searching and experimenting to try to solve them.

One structural problem, however, that does *not* exist is the de-industrialization of American industry. And one set of government measures that we do *not* need is an industrial policy under which the federal government tries to play an important role in determining the allocation of resources to individual firms and industries.

We have enough real problems without creating new ones.

1. Ira Magaziner and Robert Reich, *Minding America's Business*, Harcourt Brace Jovanovich, New York, 1982, p. 4.

2. In a forthcoming Brookings book, Robert Z. Lawrence documents in substantial detail the absence of any trend toward de-industrialization in the United States during the 1970s and, in particular, the fallacy of the proposition that international trade has contributed to depressing output and employment in American manufacturing. This section of the paper owes much to his work.

3. To reduce distortions caused by cyclical influences (U.S. recessions in 1970 and 1980), average output in 1969–70 and

1979–80 was used to make the decade output comparisons. The European average was held down by the very poor performance of the United Kingdom, but even if the United Kingdom is excluded from these calculations, the growth of manufacturing output in the United States still exceeded that of the rest of Europe as reported by the OECD data. The U.S. Bureau of Labor Statistics produces an alternative set of manufacturing output measures for selected countries; according to these data, the United States outperformed Germany and the average of eight European countries, but grew less than the European average (33.5 versus 36 percent) if the United Kingdom is excluded.

4. During the cyclical peak of the Vietnam war boom, 1965–69, the constant-dollar manufacturing share averaged slightly higher (30 percent) than it did in both the early years of that decade (28.2 percent) and the last years of the 1970s (28.6 percent), but by no more than can be explained by the strength of the boom. In a regression equation fit to data from 1955–80 that linked the manufacturing share to a cyclical variable and a time trend, the time trend did have a very small negative coefficient of marginal statistical significance. The trend was so slight that it would require some thirty years to reduce the share by one percentage point. There was no evidence that the trend became larger in the 1970s.

5. Marc Bendick, Jr., and Judith Radlinski, "Workers Dislocated by Economic Change: Do They Need Federal Employment and Training Assistance?," National Commission for Employment Policy, *Seventh Annual Report*, Appendix B.

6. Long-term unemployment rates (percent of the labor force) in 1979 were: United States (1.14), United Kingdom (1.92), France (4.41), Germany (3.35). The long-term unemployment definition—fifteen weeks or longer for the U.S., fourteen weeks for the U.K., and three months for France and Germany—does bias the U.S. rate down relative to the others, but not by enough to account for those differences. *Economic Report of the President*, January, 1981, p. 127. These findings were confirmed by a later OECD analysis reported in *Economic Outlook*, July, 1983, p. 46 (Table 15).

7. Martin Neil Baily estimated, more generally, that none of the slowdown in American productivity growth since 1973 can be explained by a shifting composition of output among major American industries. Baily, "The Productivity Growth Slowdown by Industry," *Brookings Papers on Economic Activity*, 2:1982, pp. 445–51.

8. Based on OECD estimates of gross fixed capital formation as a percent of gross domestic product (GDP). *Economic Outlook 1960–1980*, Table R-3. The difference between GDP and GNP is small and does not affect the basic comparison between the United States and Japan.

9. Interview in *Manhattan Report on Economic Policy*, Manhattan Institute for Policy Research, Vol. II, No. 7, October, 1982.

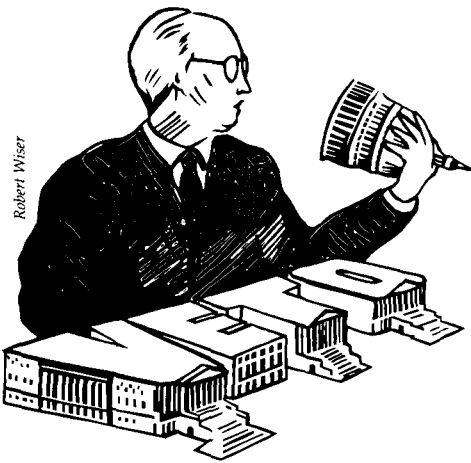
10. Paul Krugman, "Targeted Industrial Policies: Theory and Evidence," a paper prepared for the Conference on Industrial Change and Public Policy, sponsored by the Federal Reserve Bank of Kansas City, August 25–26, 1983, pp. 46–49.

11. 1983 growth as forecast by the OECD, *Economic Outlook*, July, 1983.

12. Assar Lindbeck, "Industrial Policy as an Issue in the Economic Environment," *The World Economy*, December, 1981, pp. 391–405.

13. Krugman, op. cit., pp. 6–8.

14. The chief executive of a firm producing semiconductors has recently argued that his industry does not need special government help—only a "Buy America" provision for its products.



The Legislative Veto: A Bounced Check

James L. Sundquist

WHEN THE SUPREME COURT this past spring found itself forced to decide the long-simmering issue of the legislative veto, a majority of the justices took a "strict constructionist" approach. They asked themselves, "What did the Founding Fathers, when they met at Philadelphia nearly two hundred years ago, intend?"

After long and arduous deliberation — so arduous, indeed, that the question was carried over from one term to the next before the Court finally resolved it — a six-justice majority concluded that the Founders did not intend to include the legislative veto in their constitutional design. If they had meant to permit it, Chief Justice Burger wrote for the majority, they would have said so. But they didn't.

Accordingly, the Court invalidated 207 legislative veto provisions in 126 laws. The decision, said Justice White in his dissent, "strikes down in one fell swoop provisions in more laws enacted by Congress than the Court has cumulatively invalidated in its history." Thus, said White, the decision was "of surpassing importance."

That may turn out, in the long run, to have been an exaggeration. The Congress is sure eventually to find other, valid ways of controlling the executive branch in as many of the 207 areas of governmental activity as it still wishes to control. Until the new and substitute laws are written there will be much uncertainty, and in some areas a temporary increase in authority for presidents, administrative agencies, and independent regulatory commissions.

The substitute devices for congressional control will be, unfortunately, more cumbersome and awkward. As the Chief Justice conceded, the legislative veto has been "a convenient shortcut...an appealing compromise." Some of the certain results of the decision, then, will be a loss of governmental efficiency, a heightening of the level of conflict between the Congress and the executive, and exacerbation of the normal tendency toward stalemate and deadlock in the policy-making process. Less certain, but highly probable, is a net ultimate loss in the authority and discretion of the executive branch.

Why the Legislative Veto Grew

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In the concept of the Founding Fathers — and of the Supreme Court strict constructionists — the Congress writes laws authorizing the executive branch to do things, and the executive branch then does them. The trouble is, the Congress does not always know precisely what it wants done — and usually for very good reasons. Sometimes, the means to an objective are

simply too uncertain. Sometimes, the executive branch must be authorized in advance to cope with events that have not even happened. In such cases, where the activity to be authorized cannot be defined exactly, the Congress has two choices: Either it can give the executive branch a broad delegation of power to do as it sees fit, or it can withhold the power until such time as it is prepared to be precise.

Using this proviso, the Congress often found itself ready to delegate powers to the executive that it had never been willing to grant before.

It is because the Congress has so often found this to be an unhappy pair of choices that the legislative veto was invented. The device has permitted the Congress to steer between the alternatives, delegating and withholding power at the same time. The legislators say to the executive, in effect, "Go ahead and act, but if we disagree with what you do, we reserve the right to disapprove."

Using this proviso, the Congress often found itself ready to delegate powers to the executive that it had never been willing to grant before. The case that came before the Court is a typical, although relatively minor, example of such a delegation. Until 1940, the Congress had always regulated immigration through precisely-written statutes that the Justice Department was directed to enforce to the letter — a relationship between the branches conforming exactly to what the Founders had in mind. But letter-of-the-law enforcement affecting thousands of illegal aliens resulted in severe hardship in many individual cases, and administrators and legislators agreed that some deserving immigrants ought to be exempted from deportation orders. Whenever they identified a worthy case, the exemption was made through an Act of Congress — termed a "private law" — that named the excepted individual.

The system worked, but it was cumbersome. The private bills had to be drafted, approved by committees in both houses, passed on the floor of each house, then signed by the president. On occasion, they could be controversial; one day the House spent five and a half hours debating four private bills. Eventually, someone said: Let's simplify all this. Whenever the two branches agree, let the Attorney General do on his own what has heretofore been done through private bills; when they disagree, reserve for the Congress the power that it has always had to say no. So a two-house legislative veto was written into law in 1940, and converted to a one-house veto in 1952. It was when the Attorney General excepted one Jagdish Rai Chadha of Kenya from deportation in 1974 and the House of Representatives disap-

proved his action that the historic legislative veto case started its long journey to the Supreme Court.

Most of the legislative veto provisions, of course, involve far more significant delegations of power. The earliest, enacted in 1932 and renewed at intervals thereafter, permitted government departments and agencies to be reorganized by presidential actions subject to a congressional veto — instead of by statute, as had always been the case before. Few presidential plans have been rejected, and, consequently, much reorganization has been accomplished. Two veto provisions enacted during the Watergate era helped to resolve the central issues in the stormy confrontation between President Nixon and the Congress. One was contained in the Congressional Budget and Impoundment Control Act of 1974, welcomed by the President, which authorized him to defer, subject to disapproval by either house, expenditure of appropriated funds; Nixon had freely impounded billions of dollars in appropriations during the preceding two years, but the courts had found that he had seized the power unconstitutionally. The other was the heart of the War Powers Resolution of 1973, enacted over the President's veto; that act authorized him to involve U.S. forces in combat but required him to withdraw them if the Congress did not approve the action within sixty days.

After its clash with Nixon, the Congress began writing legislative veto provisions into new grants of administrative authority much more frequently, almost routinely — restricting delegations of power in such fields as energy, education, election campaign finance, financial aid to New York City, foreign aid, military arms sales, and international trade.

During this period, the veto became much too convenient a device, in the view of executive branch officials and many congressmen as well. For no purpose more noble than to give members of Congress and their staffs a role in the administrative process, veto provisions were attached to grants of power that, in previous decades, would have been freely made on an unrestricted basis. Yet, if the device was overused, it nevertheless remained valuable as a bargaining chip to enable the executive branch to win delegations of authority that it could not have gotten otherwise. Thus, in 1979, the Congress became hopelessly torn among competing regional and occupational interests in trying to write criteria for the executive to follow in preparing a standby gasoline rationing plan. Finally, President Carter asked the Congress to let him resolve the conflicts and prepare a plan, and the legislators in either house could veto it if they did not like it. On that basis, they were happy to make the delegation, and when the administration plan was sent to Capitol Hill, they thought better than to reignite the earlier conflict. By simply not acting, both houses allowed the plan to take effect. Ironically, at the time that Carter was proposing the legislative veto as the most practical way of getting a gasoline rationing scheme adopted, he and his administration had been officially on record for a year — and would remain on record — as determined to win a Supreme Court decision outlawing the veto in most, if not all, of its applications, and it was his Justice Department that brought the *Chadha* case before the

high tribunal.

In addition to applying the veto to new delegations of power, the Congress during the 1970s also began writing veto provisions into grants of power that had long since been made. All regulations issued by the Federal Trade Commission, for instance, were made subject to reversal, and the Congress subsequently exercised that power in rejecting a regulation that the Commission had issued to govern sales of used cars. In 1976, nearly two-thirds of the House voted for a bill that would have applied the legislative veto to *every* regulation issued by *every* agency of government, and such a blanket measure continued to receive strong support in the House, although it never won the support of a majority in the Senate.

It was this excessive zeal to extend the veto to the regulatory process that aroused the determined opposition of some legal scholars and of the environmentalists and consumer organizations who expressed their glee when the *Chadha* decision was announced. Lawyers pointed out that careful procedural safeguards had been established to govern the regulatory process in the executive branch — equal access by all parties, all proceedings in public, decisions made on the record, and so on — while in its exercise of the legislative veto the Congress followed no such rules. Agencies were forced to negotiate their regulations with congressional staff, often in secret, with no record and no assurances that all affected parties would be heard or would even know what was going on. Critics contended that campaign contributions — by the used car dealers, for example — could be given undue weight in congressional decision-making.

At its worst, clearly, the legislative veto did contain serious potential for abuse. But at its best, it was of great utility in winning for the executive branch delegations of power it could not otherwise receive. It was a means of resolving conflict between the branches and establishing satisfactory working relationships that would enable the government to act. It was developed not by strict constructionists of the Constitution, obviously, but by practical politicians and statesmen. Their responsibility was not to divine what the Founding Fathers had in mind in the eighteenth century but, rather, to make the constitutional system work in the twentieth. How could the inefficiencies, delays, hiatuses, conflicts, and deadlocks inherent in a government of separate and competing branches be overcome? For this purpose, the legislative veto came to be what Justice White called it in his dissent: “an important if not indispensable political invention.”

What Happens Next?

The immediate consequence of the Court decision is that 207 legislative veto provisions are invalidated, but no one knows how many of the 126 laws containing those provisions are unconstitutional in their entirety. That turns on the question of severability. In the case before it, the Court held that the veto provision was severable, and the rest of the law was therefore unaffected. The executive branch thus received an enhanced grant of power — all the discretion with none of

the restraint. But whenever the veto clauses are found not to be severable, entire laws will fall.

To decide whether a veto provision is severable, the judges have to determine congressional intent. If the Congress had understood the proper limits on its power then as it does now, would it have enacted the law without the veto or would it have withheld the delegation? To divine what 535 congressmen would have done in hypothetical circumstances in more than two

But the Congress will not just sit still awaiting judicial pronouncements. It will be proceeding case by case to clarify its intentions for the future. . . .

hundred separate instances is surely one of the most prodigious tasks of mind-reading ever assigned to anyone.

But the Congress will not just sit still awaiting judicial pronouncements. It will be proceeding case by case to clarify its intentions for the future, if not the past, by passing fresh legislation establishing new executive-legislative relationships — or reestablishing old ones — in disputed areas.

That process has already begun. Only six days after the Court decision, an authorization bill for the Consumer Product Safety Commission (CPSC) was before the House. Representative Levitas of Georgia, the House's foremost advocate of the legislative veto, proposed an amendment that would withhold rule-making power from the CPSC. Let the Commission send us its proposed regulations, said Levitas, and if we like them we will enact them into law. Representative Waxman, manager of the authorization bill, battled the Levitas amendment as an emasculation of the CPSC — converting it from a rule-making to an advisory body — and proposed an alternative: Let each proposed regulation lie before the Congress for ninety days, during which time the legislators can pass a bill rejecting any regulation they do not like. To Levitas and his allies, the Waxman amendment amounted to surrender, because even if the Congress can find the time and the will during the ninety-day waiting period to initiate a law reversing the Commission, the President can veto it, and two-thirds majorities would then be required to disapprove the regulation. Unable to select between these conflicting approaches, the House approved them both, leaving it to a House-Senate conference committee to make a choice.

In this particular case, since Waxman, not Levitas, will represent the House on the conference committee, one may predict that his more permissive amendment will prevail. And this option will no doubt be selected in other cases (sometimes, probably, without the waiting period), whenever the key members of Congress

are more concerned with supporting an administrative agency than restraining it.

But the Levitas approach will be adopted in other cases, where the Congress places a higher value on restraint. The Congress can simply delegate power in dribbles rather than dollops. It can authorize only the planning of major programs or actions, withholding authority to act until it is ready to approve the plan. Thus, during the 1950s, when President Eisenhower vigorously protested — and, on a couple of occasions, vetoed — public works bills that permitted congressional committees to disapprove proposed projects, the Congress invented two-stage procedures. It authorized the agencies to plan projects; then, when the plans were ready, it reviewed them and authorized the projects.

One can visualize that recourse in many of the current cases. Having lost its veto over arms sales, for instance, will the Congress respond by granting a blanket power to the president to sell arms to anybody, including Saudi Arabia or Jordan? Or will it tell the president: When you have a deal worked out, bring it to us and we will authorize it if we choose? The latter would appear to be the better bet. It will be the likelier course, too, on reorganization of the government (in fact, it is the present course, because President Reagan never won reorganization power even subject to a veto) and on deferral of expenditure of appropriated funds. Similarly, as under the Levitas amendment to the CPSC bill, some regulatory agencies will be turned into advisory bodies, at least for certain types of regulations.

When the Congress adopts two-stage procedures, the need for it to act by statute at the second stage (instead of allowing actions to happen by simply not vetoing them — that is, by doing nothing) will add to the workload of an already overloaded legislative branch. Government executives will have to spend even more of their time dealing with, and bickering with, the Hill. All this the Chief Justice recognized. The processes of government, he acknowledged in his majority opinion, “often seem clumsy, inefficient, even unworkable,” they often result in “cumbersomeness and delays,” and “delay, untidiness, and potential for abuse” are “obvious flaws.” But the flaws and inefficiencies were “consciously” accepted in 1787, he argued, in the greater interest of making sure that “arbitrary governmental acts” would not “go unchecked.” There is irony in the Burger reasoning, for it is precisely to check arbitrary governmental acts — by the executive branch — that the legislative veto was devised. What prevents arbitrary government is not the independence of the branches that Burger was intent on upholding. It is just the opposite — the “checks and balances” by which an act of one branch is made dependent on approval by another. The legislative veto is an additional check and balance that the Founding Fathers did not think of. If it violated the Constitution’s language, it actually served to reinforce the very constitutional principle the Chief Justice chose to cite in striking it down.

In many instances, the almost-all and almost-nothing alternatives reflected in the two CPSC amendments will still appear to the Congress as an unhappy, or even

unworkable, pair of choices. In particular, whenever the government must be empowered to act quickly a two-stage procedure is not suitable, and yet the Congress may consider an unrestricted delegation to the executive quite out of the question. Here the War Powers Resolution of 1973 is the prime example. The Congress concluded that it could not deny to the President altogether the power to send military forces into combat situations without specific authorization, for crises arise and must be dealt with instantly, whether in the middle of the night or on a Sunday afternoon or when the Congress is on vacation. On the other hand, the legislators were adamant against relinquishing their constitutional power to declare war, through an unrestrained grant of power to the president. Giving the president the war power — but limiting it to sixty days — was an ingenious middle course that the legislative veto device made possible. In such situations, the Congress is still likely to regard some middle course as a practical necessity, and it will be searching for new devices that will survive judicial scrutiny.

One instrument with a long tradition springs to mind: the appropriations rider. A rider typically begins, “No funds appropriated under this or any other act may be expended for...” and concludes with language imposing whatever restriction the legislators desire. The sixty-day limit on presidential discretion contained in the War Powers Resolution could, presumably, be incorporated in a rider and, judging from the precedents, it would be upheld as a valid exercise of the Congress’s power of the purse. Riders may be attached to authorization bills as well. Presidents may resist such restrictions by vetoing the bills on which they ride, but presidential vetoes can be overridden by two-thirds of the Congress; moreover, presidents can veto such bills only on pain of acute confrontation with the Congress and at the risk of bringing the operations of vital departments and agencies to a halt.

In the immediate aftermath of the *Chadha* decision, some members of Congress searched for a universal response that will fit all the 207 cases. Some suggested that a “summit conference” between the branches be held, to work out a new pattern of relationships. But the quest for a broad, uniform solution will be unproductive, because the range of veto provisions is too broad and the types too diverse. The 207 delegations of power now subject to the veto will have to be reviewed one by one, piecemeal, and assigned to their proper category — those to be granted, those to be withheld, and those to be subjected to an equivalent of the old legislative veto restriction, through an appropriations rider or similar device. Predictably, the Congress will delegate power to the President in the relatively unimportant areas while retaining control over actions that are significant and controversial.

Looking further ahead, legislators will need to decide whether their veto was a mechanism of such practical indispensability, as Justice White suggested it was, that the Constitution should be amended to make it legal. At least one proposed amendment has already been introduced in the House, and the question will no doubt be on the agenda of constitutional reformers for years to come.

Clean Air and Regional Protectionism

Robert W. Crandall

ENVIRONMENTAL POLICY-MAKING is often portrayed—especially by environmentalists—as a struggle between good and evil, between those who would make the world safe for living things and those who are bent on despoiling the planet. This view of the process is, to say the least, oversimplified. To say more, it overlooks an extraordinarily important feature of environmental politics: a regional battle between the growing states in the South and West and the declining states in the North and East. The reason for this battle is that environmental controls can and do affect different regions differently; they impact the geographic distribution, as well as the overall rate, of economic growth.

Nowhere is the regional struggle over environmental policy more clearly reflected than in the design of the Clean Air Act. After more than two years of trying to change this statute, the Reagan administration and some of its business allies have nothing to show for their efforts. The reason cannot be that the Act has led to spectacular accomplishments in reducing pollution; in fact, such successes are difficult to identify. The lack of enthusiasm in Congress for reforming the Clean Air Act seems to be based instead on a reluctance to tamper with the complex regional trade-offs embodied in the Act.

The Politics of Clean Air

Prior to 1970, the responsibility for air pollution control was vested in state and local governments. Congress amended the Clean Air Act in that year to impose federal controls on new sources of industrial pollution. (Automobile exhaust had been subjected to federal standards since 1967.) States continued to be responsible for setting standards for older pollution sources, but the federal government was now given rather weak authority to require that these standards be sufficiently strict to meet national air quality goals.

A new Environmental Protection Agency was established in 1970 by an executive branch reorganization plan. This new agency was immediately thrown into the fray—administering the automobile pollution controls, approving state plans, setting new-source standards, monitoring air quality, and enforcing the complex set of regulations spawned by this new federalized approach.

One of the stickiest issues for the new EPA in its first five years was the establishment of a “nondegradation” policy. Environmentalists insisted that the 1970 Clean Air Act Amendments required EPA to set even tighter standards for areas with clean air than for those with dirty air. This approach was purportedly designed to preserve the pristine areas of the coun-

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It seems quite clear that members of Congress from the Frost Belt are the strongest supporters of a set of policies that deliberately discourage the construction of new plants in those regions of the country where new facilities are most likely to be built—the South and West.

try while attacking the heavily-polluted ones with ever tighter controls on industry and automobiles. There are appealing arguments for this policy that draw upon dramatic allusions to grand vistas in Yellowstone or Yosemite, but the policy also limits industrial growth in vast areas of the South and West that have no natural vistas of any note.

In 1977 amendments to the Clean Air Act, Congress formally built the nondegradation policy into the statute. In addition, standards for new industrial and utility plants — especially those with access to low-cost, low-sulfur western coal—were made much more onerous. Congress deliberately attempted, in the name of clean air, to reduce the use of low-sulfur coals by requiring prospective new sources to install expensive stack-gas scrubbers regardless of the sulfur content of the coal they used.

The nondegradation and new-source policies built into the Clean Air Act are potentially disastrous for the growing southern and western regions of the country as we return to economic prosperity. Were these policies consciously designed to hold down growth in these regions? In a recently published Brookings study, *Controlling Industrial Pollution*, I found that congressional support for strong environmental measures comes principally from representatives of high-income, low-growth states in the northern sections of the country—and that votes for these measures are not correlated with local air or water quality. Similarly, Peter Pashgian of the University of Chicago has found that the votes for nondegradation policy come from the urban, industrialized congressional districts of the North, not from the clean air districts elsewhere. It seems quite clear that members of Congress from the Frost Belt are the strongest supporters of a set of policies that deliberately discourage the construction of new plants in those regions of the country where new facilities are most likely to be built—the South and West. Not surprisingly, representatives from those regions have been less than enthusiastic about the policies now in place.

Is the Clean Air Act Working?

Even though air pollution control policies have been skewed to protect the slower growing regions of the country, that distortion might be tolerable if these policies were working to save us from smothering in our own discharges. In fact, data on air quality cannot support the conclusion that the policies are working. It appears that some progress has been made in air pollution control since 1970, but this progress has not been as rapid as that apparently achieved in the 1960s. That assessment is necessarily tentative, however; air pollution monitors have been poorly located and inadequately maintained — and in any event there are far too few of them to allow us to make definitive judgments about air-quality trends. Moreover, population has moved out of central cities — where the monitors are located — and many power plants have followed. It is no wonder, then, that the monitors show some decline in sulfur oxides or carbon monoxide.

Congress has been quick to seize upon each new public health scare as a reason for a new solid-waste, toxic-substances, or drinking-water statute, but it has been remarkably quiescent in its response to repeated reports from its own General Accounting Office that the air-quality monitoring network is severely deficient. We spend more than \$20 billion per year controlling air pollution, but Congress seems uninterested in finding out whether any of that expenditure is affecting air quality. Is this because Congress simply wants to rest on its laurels for having passed ambitious legislation, while leaving the difficult tasks of “implementation” to the executive branch? Or is it because the Clean Air Act is in fact a regional protection act, intended to discourage industry from gravitating southward or westward?

The regional politics of clean-air policy are best illustrated by the continuing debate over how to reduce sulfur oxide emissions. In the 1970s, much of this debate (and much of the associated policy activity) was focused on new sources, to the detriment of the growing regions of the country. Now attention has shifted to existing sources and acid rain, but the pressures to deflect the costs of control from northern polluters to southern consumers continue.

Electric Utilities and Sulfur Oxides

The policy enacted in 1977 to deal with sulfur oxides is the most extreme manifestation of regional politics in the Clean Air Act. With the enormous reserves of low-cost, low-sulfur coal in western states such as Wyoming, Colorado, and Montana, this country should be able to meet its electric power needs efficiently and cleanly by moving towards coal-burning facilities. Indeed, the growth in western coal production is evidence of economic rationality in the energy market. Unfortunately, there are miners of high-sulfur coal in Appalachia and the Midwest who regularly instruct their congressmen to eschew economic rationality in favor of regional protectionism. These representatives have combined with environmentalists to produce a truly bizarre policy.

In the 1977 Clean Air Act Amendments, EPA was ordered to require, in new-source regulations for fossil-fuel burning facilities, the maximum feasible *percentage reduction* in emissions. This meant that EPA was to require similar percentage reductions in the generation of sulfur oxides from all such facilities even though the initial sulfur content of the coal used by these facilities varied. Why not simply set a tight standard based on absolute *emissions* of sulfur oxides? The reason is simple: Under a standard of that sort, midwestern and western utilities would turn to low-sulfur coals mined principally in the West. If the "unfair" advantage of western coal were removed by requiring the same control technology, such as flue-gas scrubbers, to be used regardless of sulfur content, then utilities in the Midwest would be more likely to use cheap, sulfur-laden local coal.

The folly of this forced scrubbing policy was made clear in the analysis done by EPA, during the Carter administration, of its options under the new law. According to that analysis, requiring full scrubbing of all stack gases generated by new power plant boilers would be so expensive that many utilities would be discouraged from modernizing their plants. Many old plants, exempt from these requirements, would be virtually unconstrained, free to belch five to ten times

more pollution than the new plants per kilowatt hour of electricity generated. The postponement of replacement decisions would be so widespread that it would more than offset any favorable effects from flue-gas scrubbing at such new plants as would actually be built. As a result, the most onerous standard would result in more emissions, and \$1.1 billion more in annual costs, than a "partial" scrubbing standard. Despite this evidence, environmentalists continued to press for the tightest "full scrubbing" standard. EPA finally decided to allow utilities with access to low-sulfur coal to utilize a less effective and less expensive "dry scrubbing" option. Environmentalists argued that even this slight concession to rationality violated the statute, but the courts upheld EPA's decision.

The counterproductivity of the standard adopted is exacerbated by the fact that scrubbers do not work well unless they are monitored and kept in good working order by teams of highly-trained technicians. The states generally lack the enforcement resources to assure that such attention is given to the operation of the scrubbers. If utilities are required to use scrubbers regardless of the sulfur content of their coal, most will opt for high-sulfur local coal to save money. As a result, when the scrubber at a new plant fails to work to specifications, that plant will spew forth sulfur oxides in far greater



Lise Gladstone

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quantities than a plant using low-sulfur coal. But the jobs of those who mine high-sulfur coal will be protected, at a cost of several hundred thousand dollars per year per job.

The number of eastern and midwestern coal mining jobs saved by the expensive, inefficient new-source standard is not very large. A recent study by the Congressional Budget Office estimated that this standard would increase eastern and midwestern coal production by only about two percent by the year 2000, but would add approximately \$4 billion per year in control costs by the same year. Surely, this \$4 billion could be spent more effectively and efficiently in solving other problems. But if the standard's impact on coal production is small, why is there such strong resistance to repealing it? The answer may lie once again in the regional distribution of the costs imposed. According to an earlier EPA study, full scrubbing adds as much as eleven percent to electricity costs in the Southwest (where low-sulfur coal is available at a low cost), but less than one percent in the industrial Midwest (which has little low-sulfur coal). If Congress wanted to penalize the southwestern growth areas, it certainly has succeeded.

Acid Rain

The excessive attention given to new sources of sulfur oxides has deflected attention away from the real problem — uncontrolled electric utility plants in the Midwest that are responsible for a large share of the country's sulfur oxide emissions. These sulfur oxides are converted to sulfates, which pose serious health risks and are thought to contribute to the acid deposition or so-called acid rain problem.

The acidity of lakes and streams in many sections of the country, particularly the Northeast, is increasing, with severe impacts on aquatic life. Just how much of this increase can be attributed to sulfur oxides released by power plants and how much to nitrogen oxides is a matter of some dispute. Moreover, it is unclear to what

extent long-distance transport from the Midwest to upstate New York, New England, and Canada is responsible for the acidity of the water in these areas. Nevertheless, several proposals have been advanced for abating sulfur oxide emissions at older power plants in order to reduce the threat of acid rain.

One of the most prominent of these proposals is a bill introduced by Representative Henry Waxman, who chairs the House subcommittee on health and the environment. His plan would be yet another step in the process of punishing residents of the Sun Belt for environmental problems in other parts of the country. Because Congress has chosen to focus so much on new sources rather than existing ones, the Sun Belt states already pay far more than their wealthier midwestern counterparts in control costs per dollar of polluting economic activity. Now Representative Waxman proposes that a national tax on electricity generation be levied to fund the purchase of stack-gas scrubbers for the fifty dirtiest electric utility plants in the country, based upon annual sulfur oxide emissions. Since most of these plants are located in the East and Midwest, the consumers in the West and South would be subsidizing utilities in states that have not imposed pollution standards as rigorous as those now in place in the Sun Belt. Moreover, some of these plants continue to produce electricity precisely because the new-source (percentage reduction) standards are so onerous. Thus, states that have been able to avoid cleaning up their air would be subsidized by tax receipts from consumers in other states who have already paid a higher than necessary price for controlling emissions from new plants.

Directions for the Future

The last ten years have not been a halcyon period for economic growth. The fact that environmental policy in general, and clean-air policy in particular, is biased against growth and against the growing areas of the country may not have had major consequences during a period in which inflation, two oil shocks, and three recessions have done their part to reduce the incentives for investment. But if the economy is finally rebounding from the chaos of the 1970s, as the administration insists, we shall soon feel the effects of these environmental policies on new industrial and utility investment. It is therefore important that the new-source and nondegradation provisions in the Clean Air Act, which discourage such investment, be modified as soon as possible. In addition, attempts to deal with acid rain should concentrate on taxing the purported evil — sulfur oxide emissions in the eastern region of the country — rather than on taxing electricity generation in areas of the country where the problem is much less severe. One wonders when members of Congress from the South and West will be asked by their constituents to account for the inequities that they have allowed to be built into the current Clean Air Act. Even those of us living in the northern regions should be concerned that environmental policy is so skewed against investment and growth during a period in which it is generally conceded that savings and investment are too small a share of the national income.

Deadlines, Common Sense, and Cynicism

R. Shep Melnick

ON JUNE 2, 1983, the House of Representatives witnessed what even the participants described as a bizarre debate. The measure before the House was an appropriations bill rider prohibiting the Environmental Protection Agency from imposing sanctions on states that had failed to meet air quality standards by the 1982 deadline established in the Clean Air Act. The House girded for another battle between advocates of aggressive pollution control and those congressmen sympathetic to the Reagan administration's call for "regulatory relief." But this time many of the key players seemed to switch sides. Those who for years had led the battle for rigorous and vigorous enforcement of environmental regulations not only supported the rider, but chastised former EPA Administrator Anne Gorsuch for what they termed her "heavy-handed" imposition of sanctions and called on her successor to show more flexibility in accommodating those states making good faith efforts to comply with the Act. Equally curious was the fact that many of the congressmen who in 1982 had spearheaded an effort to weaken the Act now opposed the rider and warned that withdrawing the sanctions would undermine national pollution control efforts. What was going on here?

On its surface, the controversy was a simple dispute over statutory interpretation and legislative intent. The Clean Air Act requires the EPA to establish a number of health-based (primary) air quality standards, and makes the states responsible for developing implementation plans to assure their attainment. The Act also prohibits the construction of new sources of pollution in states that fail to write and enforce plans that "provide for attainment of national primary ambient air quality standards not later than December 21, 1982." Administrator Gorsuch argued that any state plan that had not *resulted* in attainment of national standards by the end of 1982 had not in any meaningful way "provided for" such attainment. She therefore announced her intention to impose a construction moratorium in the 213 counties throughout the nation that continued to exceed primary standards. Those supporting the appropriations rider, however, claimed that her interpretation distorted congressional intent. They argued that a state plan had provided for attainment if the state and the EPA had *estimated* in 1979—when state plans were submitted and approved—that implementation of the plan had would result in attainment. The irony, of course, is that the environmental advocates making this argument had for years opposed basing regulatory action on vague administrative estimates and informal agreements rather than on clear numerical standards, and had been particularly (and understandably) reluctant to leave such discretion in the hands of the Reagan administration's EPA.

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This seeming reversal of roles quickly becomes understandable once one examines the political context of the debate. The Reagan administration and many members of the business community consider the Act far too restrictive and have sought to revise it. By contrast, environmentalists are content with the basic structure of the Act and have opposed any amendments that fail to tackle such growing problems as acid rain and airborne carcinogens. Frantic congressional activity on air pollution yielded only stalemates in 1982. Administrator Gorsuch viewed the imposition of a construction moratorium as a way to force Congress to act. There can be little doubt but that her actions were, as environmentalists charged, politically motivated. But it is also true that environmentalists' efforts to delay the imposition of sanctions were motivated by an equally political calculation of legislative advantage.

It is tempting to dismiss this debate over deadlines as a quaint artifact of the brief reign of Anne Gorsuch Burford or as simply another illustration of how politics can intrude on policy-making. The importance of the eventual passage of the rider was lessened when, shortly before the appropriations bill became law, newly appointed Administrator William Ruckelshaus announced that he did not favor rapid or wholesale use of sanctions.

In fact, the primary lesson that this strange series of events helps us to focus on is that rigid deadlines for meeting air quality goals have not worked in the past and cannot work in the future. Since congressmen and commentators alike have been remarkably slow to recognize the bankruptcy of the "action-forcing" strategy of the Clean Air Act, it is worth recounting the history of, and the reasons for, its failure.

A Decade of Delay

In 1970 agency officials advised Senator Edmund Muskie that most areas of the country could probably meet health-based air quality standards by 1980. Muskie showed he cared more about the environment than did his chief political rival, Richard Nixon, by cutting in half the time allotted in the Clean Air Act for reaching this goal. His feat of political one-upmanship was later described as "technology-forcing." But it did not force the development of pollution control technology nearly enough. By 1975 almost every metropolitan area in the country was violating one or more standards. As the deadline for compliance passed, Senator Muskie, who had previously berated the EPA for allowing polluters' clean-up schedules to slip, suddenly urged the EPA to find "flexibility" in the Act. He and his allies did not want to open the Act to amendment while the country was in a recession and the energy crisis was the leading topic of political discussion. The EPA temporized until 1977, when Congress passed amendments to the Act.

Those amendments set 1982 as the attainment deadline for most areas and 1987 as the deadline for those areas with especially serious mobile source pollution problems. In order to prevent its deadlines from being violated again, Congress added an array of sanctions: large fines for recalcitrant polluters, funding cutoffs for recalcitrant states, and, of course, the construction

moratorium. In addition, the statute prohibited the EPA from using its enforcement discretion to grant de facto extensions. According to the authors of the legislation, this was the only way to convince industry and the states that this time the federal government meant what it said.

Insiders expected Congress to make mid-course corrections as 1982 approached. But the EPA began long before that to make such corrections administratively. By 1979 it was "conditionally" approving state plans that failed to meet the requirements of the 1977 amendments. These conditional approvals were designed both to lift the construction ban and to relieve the EPA of the responsibility to promulgate fully adequate plans. (EPA's single previous attempt to write an implementation plan by itself had proven disastrous.) The fact that not all of the plans approved by the EPA would produce attainment of standards by 1982 was an open secret. Early in 1981, the National Commission on Air Quality, established by the 1977 amendments, reported that the EPA had

approved virtually all states' projections that they would meet the air quality standards even though federal, state, and local officials privately acknowledged that such projections often were based on imprecise emission inventories and inadequate projection techniques, and that they were overly optimistic. . . . Where states obviously were unable to support a projection of meeting the standards, EPA conditionally approved plan revisions based on the states' commitment to study further measures for control.

In other words, failure to meet the deadline was not, as those supporting the appropriations rider suggested, a last-minute surprise; it was, in fact, a foregone conclusion. The only real surprise was that the Carter administration's EPA was able to convince environmental groups not to challenge this strategy in court. Environmental groups generally accepted the charade, and began filing law suits only after deciding that the Reagan administration had taken it too far.

This is not to say that the threat of sanctions did not help the EPA induce polluters to install controls. The EPA and the states made significant progress between 1977 and 1982. But this was because the EPA made it clear that it would use the sanctions only against those who failed to install controls considered "reasonably available" by Congress and the EPA (including such controversial controls as scrubbers and automobile inspection and maintenance), and that it would not insist that polluters do everything and anything necessary to attain primary standards by 1982.

Recognizing that further deadline extensions would fool no one and would succeed only in diverting administrative resources to an elaborate shellgame, the National Commission on Air Quality recommended that Congress eliminate statutory deadlines and instead require periodic specifications of "reasonably available control technology" to be used by polluters in nonattainment areas. The chances for congressional adoption of this sensible proposal are remarkably slim. The recommendation drew a strong dissent from the

most ardent environmentalists on the Commission, who claimed that "abolition of deadlines would legitimize the perpetual failure to provide healthful air quality for 50 to 100 million people" and would remove "the 'action-forcing' quality needed to assure attainment." The bills considered by House and Senate committees last year would have extended rather than eliminated the present deadlines. Evidently the political appeal of deadlines has outlived their environmental usefulness.

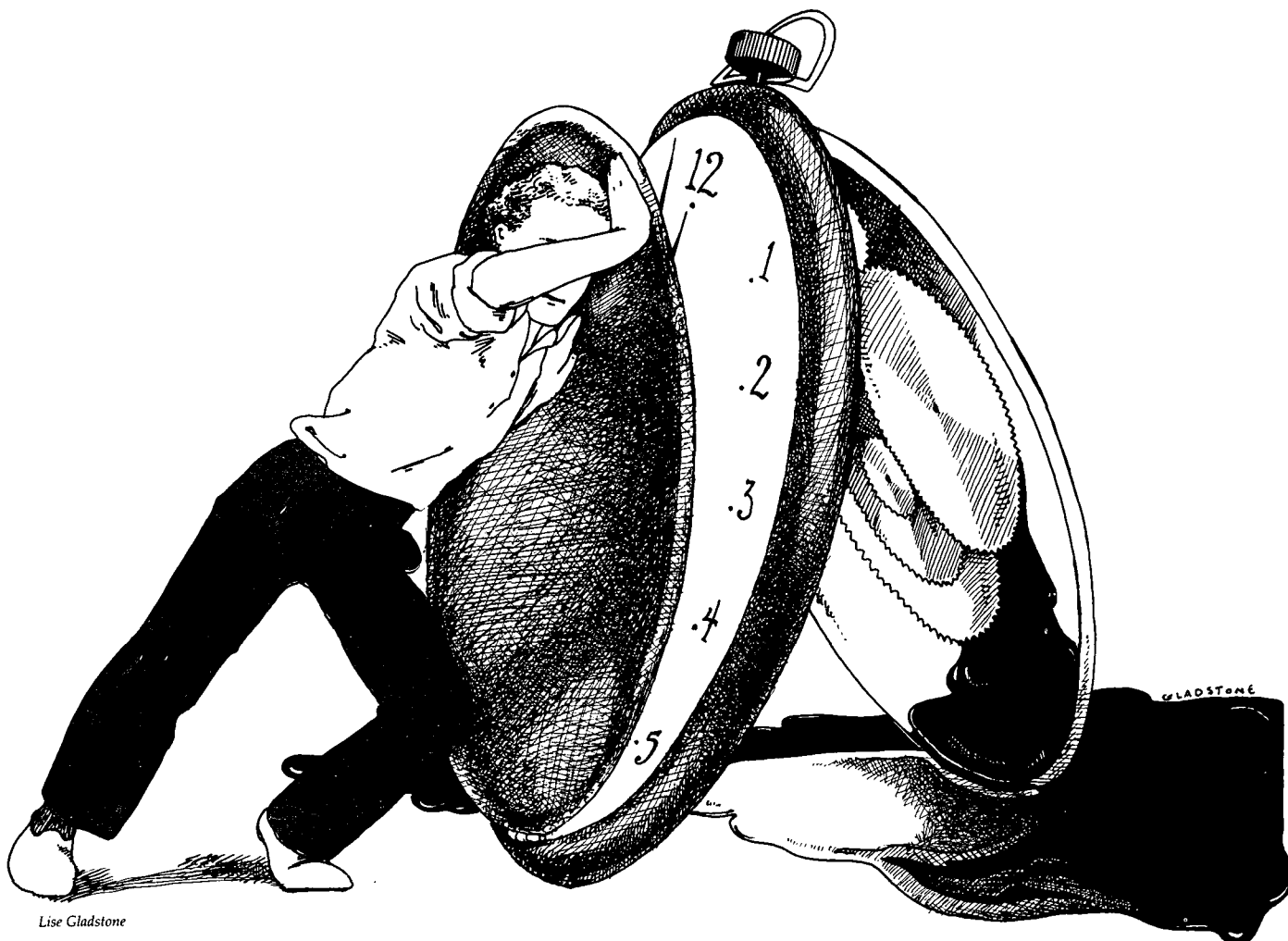
Policy Arguments and Political Assumptions

If deadlines for "forcing" the attainment of air quality standards have had nine lives, it is largely because their advocates have been quicker than cats in jumping from one justification to another. As each rationale has collapsed under the weight of experience, another has risen to take its place.

The sponsors of the 1970 Act originally claimed that deadlines were essential because of the urgent need to protect the public health. "The health of people," the Senate report declared, "is more important than the questions of whether early achievement of ambient air quality standards protective of health is technically feasible." This argument crumbled as it became apparent that for most pollutants no standard other than zero would completely protect the public health; that most

standards were based on tenuous evidence and relatively mild adverse effects; and that attainment of these arbitrary and restrictive standards would cost billions of dollars. For example, in setting its standard for ozone (smog) at 0.12 parts per million, the EPA relied to a large extent on a study showing that when six healthy adults exercised heavily (the equivalent of running six miles in an hour) and were exposed to ozone levels of 0.15 parts per million, several experienced such discomforts as headaches and chest tightness. In Los Angeles, ozone concentrations almost four times the level specified by the EPA are common. Attaining the 0.12 standard there would require massive industrial closures and restrictions on automobile use. Few doubt that such controls would have caused misery far exceeding that caused by ozone levels in excess of the standard. In short, standard-setting simply cannot be divorced from consideration of the cost and feasibility of the pollution control.

As the urgency argument came to be less persuasive, those who advocated strict deadlines adduced another justification: technology-forcing. By stimulating innovation, they argued, deadlines make the previously infeasible become feasible and thus reduce the cost of pollution control. The problem, of course, is that deadlines can stimulate technological innovation only if they are believable. Time after time, Congress has backed down—not just on deadlines for attaining air quality



Lise Gladstone

standards, but also on deadlines for reducing emissions from new cars. In effect, Congress has cried wolf too often. The future of technology-forcing lies not in the further use of phony deadlines, but in those pollution control strategies—such as the EPA's offset, bubble, and prevention-of-significant-deterioration policies—that make emission rights scarce and valuable.

Many supporters of air quality deadlines now proffer a new argument—one that focuses on who should make major policy choices. While conceding that the pace of clean-up should reflect the cost of control and that deadlines must be adjusted—that is, relaxed—periodically to reflect new information, they contend that these decisions should be made in public by elected officials rather than in back rooms by faceless bureaucrats. This is a popular line of argument among both liberals and conservatives. No one likes bureaucrats these days, and everyone seems to applaud detailed legislation.

To exercise any real control over the pace of pollution abatement, Congress must first set deadlines that are realistic, in that they produce at least a rough match between benefits and costs. Since the extent of pollution, and thus the costs of clean-up, will vary greatly from area to area, Congress must take the second step of setting different deadlines for different parts of the country. And since it is difficult to know in advance what the costs of control will be, it will always be necessary to take yet a third step: revising deadlines on a regular basis. The need for area-by-area variation of standards leads one to wonder why such important political choices should be made by Congress rather than by state and local elected officials. But leaving this highly charged issue to one side, one cannot but be impressed with the extent of responsibility this scheme would place on Congress. The "action-forcing" strategy sets deadlines not just for polluters and administrators, but for Congress as well.

It is hardly surprising that Congress has never—neither in 1975 nor in 1982—lived up to its responsibility to revise outmoded deadlines. It is always good fun to ridicule Congress for moving at a pace that makes glaciers seem swift. But Congress's proclivity for slow, painstaking deliberation is one of its chief virtues. Its multiple veto points allow large numbers of interests to be heard and in some way accommodated. Even liberals who in the 1960s decried congressional "deadlock" came in 1981 to recognize the danger of Congress being "stampeded" on budgetary matters. "Action-forcing" seldom works on Congress—and when it does, it threatens to rob that body of its chief institutional advantage.

As readers of the *Federalist Papers* know, the American constitution makes coalition-building in Congress difficult in order to guard against the dangers of factionalism. It also places the "energy" necessary for good administration in the executive branch. The history of air pollution control shows that the real adjustment of deadlines comes in negotiation among administrators at the federal and state levels and polluters. While individual legislators regularly berate administrators for failing to meet statutory deadlines, Congress has always either changed deadlines to re-

flect administrative policy or quietly indicated that administrators should ignore the law.

Those who are cynical and those who study the political science literature—and there is a good deal of overlap between these two groups—will recognize that members of Congress derive several advantages from setting deadlines that cannot and will not be met. The legislators can take credit for having embraced ambitious environmental goals, criticize administrators for having failed to meet them (a strategy that is especially attractive when the president belongs to the opposition party), and even condemn the poor bureaucrats for having threatened to impose "unreasonable" sanctions. These advantages for individual members, though, do not make the path chosen by Congress as a whole any less illusory.

The Costs of Symbolism

One could speculate about the marginal costs and benefits of retaining deadlines that almost no one takes seriously. Federal regulators may be able to convince some states and polluters that the deadlines have teeth. Bluffing works best against the gullible and the vulnerable. General Motors may have learned the game by now, but maybe the local dry cleaning establishment has not; if California cannot be pushed around, maybe New Hampshire can be. The small—and decreasing—payoff from this game must be balanced not just against its unfairness, but also against the required expenditures of administrative time and credibility.

Such speculation, though, should not distract us from the obvious. Both the advantages and disadvantages of retaining air quality standard deadlines are primarily symbolic. Environmentalists fear that the deletion of deadlines would be taken as a sign that their movement is in retreat. More importantly, they view deadlines—or, to be more precise, the ghosts of deadlines passed—as symbols of how much remains to be done in the fight against pollution. In a sense, deadlines are made to be broken. Each time we fail to meet one, we are reminded that more effort is needed, that our environment is not yet clean. Each lapsed deadline is a time for soul-searching and rededication.

This means, of course, that deadlines are also symbols of government failure. Another deadline missed—another promise unfulfilled. Perhaps it is time to question the assumption that there is no harm in having government admit failure time after time after time. In many ways regulation of air pollution in the U.S. has been a remarkable success. Exposure to harmful pollutants has gone down significantly even as the economy has grown. But we hardly ever hear about this. We only hear economists telling us how much regulation costs and environmentalists telling us that our air is still polluted. No wonder the public doesn't trust government.

Reading this June's House debate on air quality deadlines leaves one with a cynical smile. Cynicism in private can be amusing, but the spread of public cynicism can be tragic. Just as surely as pollution is harmful to public health, our strategies for protecting the environment have become hazardous to public spirit.

Alice Rivlin on the Budget



In 1975, Alice Rivlin, then a senior fellow in the Economic Studies program at Brookings, was named the first director of the Congressional Budget Office. On September 1, after more than eight years at CBO, she returned to Brookings as the director of Economic Studies. In a recent conversation, she discussed what might be done to reduce federal budget deficits and to refine the congressional budget process.

1. How would you assess the impact on the economy of federal budget deficits in the neighborhood of \$200 billion dollars?

I think the impact in the future could be very serious. \$200 billion dollars is about six percent of the gross national product. Right now, we can probably afford to have the federal government financing a \$200 billion deficit. However, as the recovery proceeds, the private sector will begin borrowing more and more to finance the plant and equipment expansion that is of the essence of the recovery, and this means that the federal government will be competing with the private sector for limited funds. That raises the prospect of competition between the federal government and the private sector that could drive up interest rates, and it could drive them up to a degree that would threaten the recovery itself. So the important thing, I think, is not this huge current deficit; it is getting those deficits coming down as the recovery proceeds through 1985, 1986.

2. When does a deficit in that range start to pinch the recovery? How far out?

Well, nobody really knows. We've never gone into a recovery with rising structural deficits — that is, deficits

not related to the state of the economy. That's the situation we're in now, and it's a scary one. It seems likely that it will put pressure on interest rates if we don't get the deficits down. Nobody knows what the magic number is, but as a goal it would seem sensible to

bring the deficits down to around two percent of the gross national product by 1987 or 1988. That's a fairly ambitious goal.

3. Where could we get expenditure reductions at this point?

Well, there is really a very limited number of programs in the federal budget that are still expanding. We've had cutbacks in most of the non-entitlement domestic spending programs, that is, grants to state and local governments and other things the federal government does. Those programs are not expanding. The things that are still increasing are, first, defense, and second, the entitlement programs — social security, medicaid, and medicare.

Among the domestic spending programs, one really has to focus on the entitlements — and particularly, I think, on medical care — if one has any hope of major cutbacks in spending, because that's where the increases are. The increases in medicare have been on the order of 17 to 20 percent a year over the last several years. Nobody really knows how to get those medical costs coming down, but unless we do, we're going to have continuing increases of major magnitude in those programs.

I think that one interesting aspect of this is that one can make the case that defense spending and medical



spending are rising for the same reason. We're not increasing the number of patients treated in our medical care system; what we're doing is increasing the sophistication of the treatment they get. Medicare costs are rising largely because the technology is increasing by leaps and bounds and making each episode of illness more expensive. Basically the same thing is happening in our military spending. We aren't increasing the size of the force; what we're doing is increasing the sophistication of the equipment that individual soldiers have, and that's what's contributing to the rapid cost increase. In neither case do we know what to do about it.

One solution is simply to put on an arbitrary ceiling — to say that medical care costs can increase no more than X percent every year and the professionals will have to figure out how to get by on that. A similar solution can be proposed for the defense budget—and has been.

■ Each of the last two administrations has suggested at one time or another that there was a substantial amount of money that could be saved by eliminating waste in government programs. Does that square with your impression?

Oh, it's a question of the definition of waste. It's certainly true in defense spending that we have consistently underestimated the cost of weapons systems. Those costs always come in higher than people expect them to. In part, this is because contracting procedures don't do enough to encourage cost minimization — and, in part, it's because weapons systems seem to become more sophisticated, and therefore more expensive, even as they are being built. But I think there undoubtedly is waste in the Pentagon procurement budget; it is very difficult, however, to devise systems that will cut that out.

In domestic spending, again it's a question of figuring out what you think is really necessary. The amount that could be saved by improved administrative procedures is probably quite small. We've done a lot of that, and administration of grants by the federal government is a rather small amount of the total in any case. The question is: Do we really need all the things that we're buying?

■ Let's switch over to the revenue side of the equation. What are the options there that you think would have a reasonable chance of serious consideration in the near term?

Well, the basic point is that, as we look down the road, if we're going to get the deficits under control we have to operate on both the revenue side and the spending side. There are going to be substantial amounts of revenue needed. That creates an opportunity for reexamining the federal tax system and seeing how to raise that revenue in a way that will be least damaging to economic growth. I think there are basically two ways to go. One could move more toward consumption taxation, taking some of the burden of the federal tax system off of the income and payroll tax. That would involve either a value-added tax or some other kind of consumer tax. Or one could go for a basic reform of the income tax to broaden the base and make it possible to raise more revenue without raising the rates — even, perhaps, while actually lowering the rates.

■ The first route, the consumption tax, what kind of impact might that have on the progressiveness of the overall tax system?

It all depends on how you do it. A straight value-added tax or national sales tax would be regressive. That's because low-income people spend more on goods and services, particularly on goods, than upper-income people do. But if you exempted food and medical care, for instance, you could make it much less regressive.

■ It's been suggested that in order to convince the public that tax increases are necessary, a certain amount of education of the public will have to be done. Do you have any thoughts on that?

I'm not even sure that's right. The public was not pushing for the Reagan tax cuts. All of the polls showed that the public was more concerned about the deficits than about having a tax cut. Now a tax increase is a harder thing to talk about than foregoing a tax cut, but even so, it's not obvious to me that there would be great opposition to a tax increase in a reasonable range so long as people understood that it was necessary to cut the deficit or to avoid more drastic spending cuts.

■ And presumably so long as they thought it was being done equitably.

Right.

■ As the first director of the Congressional Budget Office, how did you go about building the institution from the ground up?

My first priority was to recruit very good people, and I think by and large we did that. It was a good time to do it in 1975; the economy was in a recession, and nothing terribly exciting was going on in the federal government itself. We were the new game in town, an interesting new place to work, and we were able to recruit both bright young people coming out of universities and some people with experience in the federal service who wanted to try something new.

■ As you put the organization together, what lessons did you draw from looking at OMB and how it had functioned over the years?

Well, we used more or less the OMB organizational structure. We tried to think of other ways of doing it,

but basically you have to break it down the way the budget is broken down. So we had a national security division, a human resources division, and a budget analysis division that puts together all the basic numbers — and that parallels pretty much the OMB structure. We weren't copying them; it's just that it's a convenient way to organize a budget office.

I don't remember that we paid a great deal of attention to lessons from OMB. It was a different kind of a task. OMB's task is to examine programs in detail and to recommend to the President what his budget choices ought to be. Ours was not to make recommendations, but to provide analysis.

Our basic objective at the beginning was to build a high-quality, credible organization that would be useful to the Congress, and I think by and large we've done that — and I'm very pleased with it.

■ The congressional budget process itself sometimes seems to be sputtering along now and again.

Oh, it creaks and groans!

■ There are people on the Hill and elsewhere who have said that maybe we should be streamlining it a bit. Do you have any thoughts on whether some reforms might make sense after the experience of the last eight years?

Yes. First, however, I think it's important to realize that there is no way to make budget-making easy. If it's been difficult and time-consuming over the last several years, it's because the problem itself is hard and the choices are hard. I don't think it can be blamed primarily on the process.

However, there are some lessons from working with the current process. I think one of them is that it's too long and complicated. It demands too many decisions — more than can be made in the time allotted. In part, the process has adjusted to that fact by streamlining itself. For example, originally the budget process on the Hill was conceived as a two-stage iterative process in which you had a serious debate in the spring on the first concurrent resolution of the budget, then the Congress would work on all the individual spending and taxing bills, and then it would have another serious debate in September in which it put together the individual actions with the original budget targets, reconciled the parts with the whole, and passed a second and final resolution on the budget before the beginning of the fiscal year in October. It's turned out that it's just too complicated to do all that — that there isn't time for that two-stage process — and it's become clear that if you're going to make decisions on the budget that have any meaning, you have to make them early in the year. So the first resolution has become the focus of attention, and the second resolution has really gone by the board. If the decisions are made in May, the second resolution is not necessary. And the reconciliation process, the process of bringing the pieces into conformance with the totals, has been moved by common consent from the second resolution to the first one. I think that's just an example of the adaptation of the process to the necessity of making decisions more quickly.

A more drastic suggestion has been made to move to a biennial budget in which we would essentially make all of these decisions for two years and then have the intervening year to worry about something else. I think



that's sensible — not just because it would relieve the pressure on congressional decision-making, but because it would give states and localities more definiteness about what they will get from the federal government over a longer period and would facilitate planning at the state and local level.

■ When you speak of pressure on congressional decision-making, you're referring to the need for Congress to take a rest from budget decisions and look at some other things?

That's right. People have remarked that Congress doesn't do anything except work on the budget these days, and that's virtually the truth. They have not had much time for anything else, except for foreign policy. Now some would regard that as an advantage — it means that there hasn't been time to focus on school prayer and abortion and other things like that — but I know many congressmen have the feeling that they never do anything except the budget.

The Congress has in fact not enacted very much legislation in the last two or three years. There has been a marked drop-off, with very few new programs enacted at all; the President has not asked for new domestic programs, and the Congress has not enacted them.

■ What have been your impressions of the sophistication of Congress in dealing with economic analysis and economic issues?

I think it's really quite high, and it has increased in the period that I've been there. You have to realize that I work with a somewhat biased sample of the Congress. I tend to see most of the budget committee members and, to a lesser extent, finance, ways and means, and appropriations members. But the budget committees draw a hardworking, intelligent, and quite sophisticated group of congressmen. If you're a lazy or venal congressman, you don't get on the budget committee. There just isn't anything to give away. It's a naysaying function, and it's a very difficult committee to be on.

I think that debates on fiscal policy in the budget committees and in other committees, and on other kinds of policy choices as well, are — not always, but often — very good debates, well-informed and grappling with the serious issues. It's just that the issues and the choices are very hard.

Unemployment

Four Brookings experts on unemployment and job training recently gathered for a discussion. The participants in the conversation were:

Martin Neil Bailly, a senior fellow in Economic Studies and editor of a recently published collection of essays entitled *Workers, Jobs, and Inflation*.

Gary Burtless, a senior fellow in Economic Studies and the assistant editor of the Brookings Papers on Economic Activity.

Malcolm R. Lovell, Jr., a guest scholar who was U.S. under secretary of labor from 1981 until this past spring and who is organizing a conference, to be held at Brookings in December of this year, on the problems of displaced workers.

Roger D. Semerad, the executive vice president of Brookings and chairman of the board of 70001 Ltd., a non-profit job training corporation; he was a staff assistant to Presidents Nixon and Ford, with responsibility for labor, education, and veterans affairs.

What follows is an edited transcript of their remarks, beginning with an overview from Martin Neil Bailly:

Bailly: Most current forecasts predict that the unemployment rate will remain over 8 percent for the next two or three years, and that's under the assumption that there will be continued recovery. If those predictions are roughly accurate, then over the period 1980 to 1985 unemployment will have averaged about 8.5 percent. That compares with 6.2 percent for the 1970s and 4.8 percent for the 1960s. It's clear that the problem of unemployment in the U.S. is getting worse and worse, and an issue I've been looking at is to what extent the increase in unemployment is cyclical—that is to say, associated with fluctuations of demand in the economy—and to what extent it is structural.

It has been argued that the increase in unemployment between the '60s and the '70s could not have been a function of cyclical changes, because inflation was actually much worse in the '70s than it was in the '60s. I don't agree with that view. Aggregate demand was much too strong in the latter half of the 1960s. This gave the country the benefit of low unemployment, but it also resulted in accelerating inflation, which made for trouble in the 1970s. Moreover, in the 1970s the economy was also afflicted with a series of nasty shocks—the increase in the price of OPEC oil, for example—so that inflation was bad in that decade for reasons that weren't particularly associated either with the labor

market or with any excess of aggregate demand in the economy, at least as a whole. In the '80s so far, high unemployment has been the side effect of curing inflation through demand restraint.

I'd like to introduce a concept that is a little controversial, but I think useful: the natural rate of unemployment. Basically, if unemployment fluctuates around the natural rate, we say this fluctuation is cyclical. If the natural rate itself changes—increases or decreases—this is because of some kind of structural change in the economy.

I've just been arguing in effect that unemployment was below its natural rate in the '60s, was about equal to its natural rate in the '70s, and so far in the '80s has been above its natural rate. But it's also true that the natural rate itself has risen. In other words, the shifts in the unemployment rate are not due entirely to cyclical differences; there have also been structural changes. It's hard to estimate exactly how much the natural rate has increased, but my best guess is that it's gone up from an unemployment rate of about 5 percent to one of about 6 percent over the course of the last twenty-five years.

The most important reason for this increase has been a change in the demographic composition of the labor force. It used to be that mature white males made up the bulk of the labor force—54 percent in 1955. By the late '70s, they accounted for only 40 percent of the labor force—and only 20 percent of the unemployed. Young people, women, and minorities have traditionally had higher unemployment rates than mature white males, and now these groups have become larger fractions of the labor force. Thus, in 1978, when the overall unemployment rate was 6 percent, persons 16 to 24 made up half of the unemployed.

The second reason, I find, for the rise in the natural rate of unemployment is that there has been some reduction in the financial necessity to accept employment. This is partly because of the increase in government transfer programs and partly because many families now have more than one earner. There's been a trend toward greater income security for families—a very desirable trend, for obvious reasons—and it's probably had the side effect of causing an increase in the natural rate of unemployment.

A lot of people have suggested that another reason for that increase has been a change in the mix of industries; some industries have risen and some have fallen. My own work has not found that to be a major cause.

Lovell: If America is going to be as competitive as it can be in world markets, I think that one inevitable by-product of that effort will be an increase in the displacement of experienced workers. Let me explain.

I think that there is general agreement that the world economy will be better off with an open trading system, and that the United States, as a major economic force—not the economic force we used to be, but still a very major one—has an opportunity, perhaps even a responsibility, to promote and perpetuate open trading. This means, of course, that we'll have to work to be competitive within this system, and that in turn is going to require us to move rapidly into new technologies in both old and new industries. As these shifts take

Youth Unemployment

Baily: To some extent, recent increases in the natural rate of unemployment reflect patterns that are not necessarily unhealthy. For example, you'd expect to see more career experimentation among married women moving in and out of the labor force and among young people just starting up in their careers. In practice, however, unemployment—particularly among youths and most especially among minority youths—is much higher than these patterns would suggest. There clearly are some pathological problems.

I've always felt that these problems were on both the demand and supply sides of the labor market. With



left to right: Roger D. Semerad, Gary Burtless, Martin Neil Baily, and Malcolm R. Lovell, Jr.

place, some people now working will lose their jobs—either because the plants that they currently work in will be shut down or because they are at the low end of the seniority list in declining firms. Now we don't really know precisely how many workers will be affected; that will depend to some extent on how vigorously we pursue a more competitive approach. But it is important that we as a society recognize that if we are going to be competitive, there will be some human costs involved—and that these costs should not be borne entirely by the individuals who are displaced. We need to put in place public and private mechanisms to help spread the costs of unemployment. Then we will be able to move rapidly to enhance the competitiveness of U.S. industry in both domestic and international markets.

Burtless: That raises a subject that has been getting a lot of attention recently: the decline—or alleged decline—of American competitiveness. There seems to be a notion that American workers and American capital don't compete very effectively in international markets, and that, consequently, they're being displaced by foreign companies. Well, one of our colleagues here at Brookings, Robert Lawrence, has assembled evidence that leads me to doubt that proposition. It turns out that between 1970 and 1979, international trade actually contributed towards growth in manufacturing jobs in the United States. In fact, the United States was somewhat unusual among Western industrial nations in that the number of manufacturing jobs in this country rose during that period.

respect to demand, young people and women don't always have the same access to jobs that other workers have. That may be due in part to discrimination, in part to the effects of minimum wage laws. It may also be due to the fact that manufacturing jobs—paying fairly well, maybe with some prospects in them, but not requiring a lot of educational qualifications—do not account for as large a share of total jobs today as they did in the 1950s.

On the supply side of the market, I think there are problems with both motivation and skills. Young people are not being terribly well prepared in the schools. It's not just a matter of difficulties with literacy and numeracy, although those are obviously important problems; it's also a matter of inadequate vocational education. I'm not all that well-qualified to talk about the motivational aspect, but I think that when you have a history of unemployment, low job participation, and some discrimination, those factors tend to interact, and then people decide they don't want to look for jobs—they'll look for other ways of getting by.

Lovell: In addition to the problems you mentioned, Martin, there is at least one other. Many employers lack confidence in the skills of these young disadvantaged people. Whatever the precise mix of causation, employment among male minority youth has dropped precipitously since the middle 1950s, from approximately 55 percent to about 25 percent today. That's a very dramatic change—and a very serious problem. And this has taken place during a period in which we have had major efforts to deal with the disadvantaged youth

population—the anti-poverty program, various manpower and employment and training programs—and they just haven't made a dent. The situation has just gotten worse, rather than better.

Semerad: I think we should point out that spending in the CETA program, which was supposed to encompass both employment and training, was very much skewed toward the employment side. Now, under the new Job Training Partnership Act, participants in training programs will not be paid stipends. That makes sense, because the motivation for taking part in these programs ought to be the chance to get ahead by acquiring job skills, not the chance to get subsidies.



As to the inadequacy of vocational education in high schools, a problem that Martin touched on, we need to find ways to reduce the stigma sometimes attached to being on a vocational education track. Also it's important not only that vocational education courses help students to develop marketable skills, but also that they convey some more general information about succeeding in the business world. Students coming out of these courses ought to understand the language of the workplace, how to find jobs, and how to keep them.

Lovell: That's a very important point. Forty-five percent of the students who finish high school do not go on to college. That proportion may be fine in terms of the needs of business for employees with additional education.

However, I think it's essential that we take a close look at just what skills are going to be needed over the next decade or two for those entry-level jobs not requiring college degrees. That way, the high schools can provide better-focused vocational education programs, and the young men and women themselves can more readily identify the skills that they will have to acquire in order to be competitive in the job market. I have no doubt but that the sort of analysis of skill requirements that I'm suggesting would reveal large gaps in what most high schools now offer in their vocational education curricula.

Burtless: Contrary to some of the views expressed earlier, I don't think that all of the government training programs for disadvantaged youth have been disasters. In the ones that have been less successful, we've attempted to invest small amounts per young person for training and employment, and this has had very little effect. It seems to take a very large investment to make a difference in someone who's had a disadvantaged background. For example, in the Job Corps pro-

gram it costs about \$10,000 to provide a year of help to a young person. But that's one of the federal programs that seems to be successful both in reducing crime and in raising later earnings among the people enrolled in it. The summer youth program, on the other hand, which just provides a little bit of money to people over the summer and probably very little useful work experience, seems to have no impact whatsoever on their later employability.

Baily: It's also worth mentioning that wage subsidy programs have not worked terribly well either. When, for example, the government gives subsidies to employers who hire people with criminal records, it is not surprising to find that these subsidies fail to produce a huge increase in the number of former felons that are hired. But it is surprising that even those employers who do hire former felons don't bother to collect the subsidy; it's just too much trouble. That kind of program is a favorite with economists—you subsidize the wage and increase employment—but it has not worked out well.

Burtless: Martin is right. In 1981, when I was examining experience under the Targeted Jobs Tax Credit, I found that disadvantaged youths—whose jobs could be covered by the subsidies—held about two million private-sector jobs a year. Yet only 115,000 of these jobs ended up being subsidized by the program in its first two years. Evidently, millions of employers either didn't know about the program or didn't bother to apply for the subsidies if they did. This kind of experience shows that targeted job subsidies might be wonderful in theory, but they don't have much impact in practice.

Semerad: Well, our experience with the targeted tax program was that it was a boon for large companies like the Marriott Corporation, which hired a lot of young people and apparently took the accounting time needed to take advantage of the tax credit. But for smaller companies, the paperwork just wasn't worth it; it was too complicated.

Lovell: There are two aspects to training. The first, of course, is that it provides skills. The second is that it identifies a group of people as being *qualified* for employment. For example, the people who go through an apprentice program may or may not be better qualified than those of their contemporaries who do not, but they have been designated as being more qualified. Those who make hiring decisions need some rationale on which to base—and to defend—their judgments, and, particularly in connection with jobs that really require very little skill, completion of a training program can provide that rationale.

Semerad: You can dress these programs up with tax credits and subsidies, but basically what employers want is very simple: They want good hires. They don't expect or require that people already be trained in their businesses. What they want are people who are *ready* to be trained, who have the correct attitude and the necessary literacy and computation skills.

Baily: Subsidies can become a stigma, so that if there is going to be a subsidy, it should probably be a fairly general one. For example, a youth sub-minimum wage would apply to all young people and would, I think, facilitate apprenticeship programs. If you wanted to go further, you might put in place a training subsidy that

was available for use by any teenager. You might end up giving it to more teenagers than you had to, but because of its general availability, the subsidy wouldn't carry with it a stigma. I doubt that even this type of subsidy would have a big effect, however.

Semerad: Your point about the stigma attached to subsidies is really important. Giving stipends to trainees can also undercut the effectiveness of programs. In 70001, Ltd.—the nation-wide job training organization that I chair—we don't pay a stipend to kids in our programs. As a result, we find that we're working with youngsters who have decided that they're going to take care of themselves; we build on that sense of self-worth, that can-do attitude, and we reinforce it. We've worked primarily with disadvantaged kids, but now we're transferring the same combination of building skills and building self-esteem into programs for handicapped people, Vietnam veterans, and middle-aged women entering the workforce. Anything that government does that undermines self-esteem reduces potential success.

Displaced Workers

Baily: I'd like to get back to the comments that Mac made earlier about displaced workers. As Gary pointed out, Bob Lawrence has found that from 1970 to 1979 international trade created a lot of jobs in this country. While the United States has become somewhat less competitive in world markets since 1979, that's largely because the dollar has been overvalued—a trend that both Gary and I think will be reversed. My sense, Mac, is that your view is more pessimistic.

Lovell: No, I think that over time vigorous participation in the world market will yield an increase in the number of jobs and an increase in national wealth. My point is that in this process, there will be changes in the job mix in a number of industries—and those changes will force people to move from one kind of a job to another. They will obviously have less difficulty in a booming economy than in a static or declining one, but in any case there will be problems of adjustment—for example, middle-aged people whose skills are not responsive to the needs of the new technologies or workers who are displaced in geographic areas where there aren't many new jobs. So my point is that if, as I have suggested, a number of individuals are going to suffer so that the economy as a whole may prosper, then we as a society have some responsibility to share that cost and not place it entirely on those individuals.

Baily: How many people are we talking about?

Lovell: My estimate is that we're dealing with about two million people a year. The key issue is how many of those will have difficulty finding new jobs.

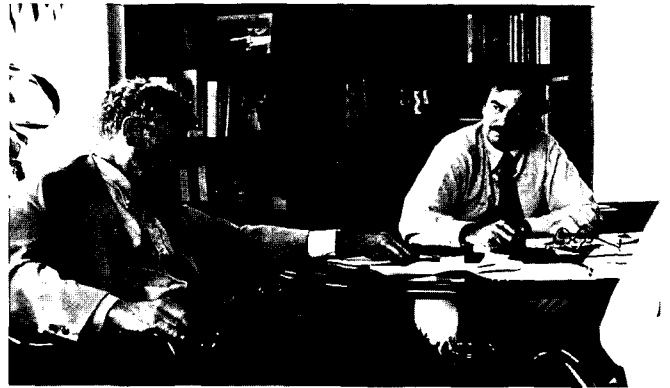
Burtless: I think that depends critically on how concentrated the unemployment is in a region. If there are a lot of declining industries in a region, then everyone in that region is going to have trouble finding jobs. But that's a regional economic problem; it's not a problem that a general displaced-worker program for the entire nation is going to help very much to solve.

Lovell: Well, it's a matter of what that program is. I think one would want to design a program that is flexible enough to deal with regional differences—and that

makes it easier for displaced workers, wherever they are, to get back to work.

We have to recognize that the permanent loss of a job—even though it's through no fault of one's own—is a psychological shock of some magnitude. I think it probably ranges after death and divorce—it's on that order of magnitude—and I just don't think it's appropriate in a democratic society for us to say that people don't need any help just because there are other jobs. They don't need debilitating help, of course; what they need are options that will help them to move on their own into new employment more quickly.

Semerad: Is this tied in with the idea of a two-track



unemployment insurance system?

Lovell: Yes, it is. Workers could be given a choice between the present unemployment insurance set-up, which provides benefits while requiring only that those drawing the benefits undertake a casual job search, and a program that would give displaced workers far more vigorous labor market exposure, training and educational options, testing, and counseling on job search techniques and problems of adjustment.

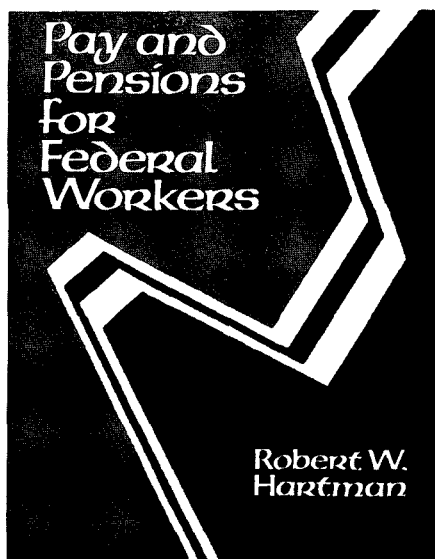
Semerad: I think that relocation will be a big problem. An older worker—even though he may have ten more productive years ahead of him—won't really want to move.

Lovell: Well, that's right. But in most areas of the country there will be jobs of one kind or another within a commuting radius of a displaced worker's residence; it's just that to be eligible for those jobs, a worker might well need some new training.

Semerad: It occurs to me that the high-tech phenomenon cuts both ways. On the one hand, we see opportunities; on the other hand, we worry about workers being displaced by robots. In my judgment, what needs to be made clear in public discussion is that what is on the horizon is not so much a total upheaval of existing industries as it is an introduction of new techniques.

Lovell: I think that's right. We're going to have an automobile industry and we're going to have a steel industry, but they probably will not employ the same percentage of the work force as they have historically.

Baily: To put all of this into perspective, I want to underscore one key point: the best program for employment that we could have right now—something that could take millions of workers off the unemployment rolls—would be a continued strong recovery. That would dwarf anything we could do with structural programs.



Federal Salaries and Benefits: The Need for Reform

Pay and Pensions for Federal Employees

By Robert W. Hartman. 118 pages.
\$7.95 paper; \$18.95 cloth.

ACCORDING TO ROBERT W. HARTMAN the system for compensating federal workers is fundamentally flawed. He finds a serious imbalance between pay levels in the public and private sectors, with both entry-level and high-level federal professionals being paid much less than their private-sector counterparts—and federal clerical workers, at least those in advanced positions, being paid more than their counterparts. In addition, he identifies a variety of problems that beset the federal retirement system, including the widespread early retirement of senior personnel, windfall gains for dual beneficiaries, inadequate benefits for some lower-level employees, and spiraling costs.

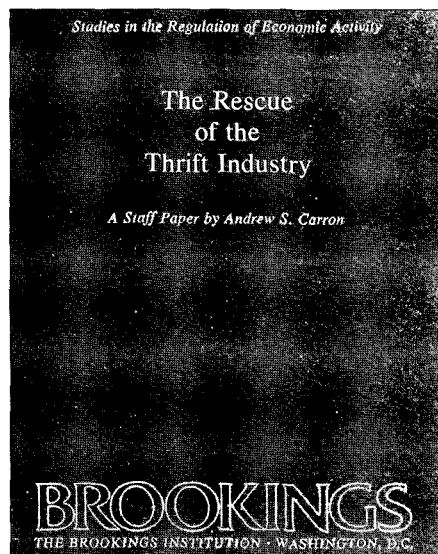
Both the Carter and Reagan administrations have attempted to hold down increases in federal pay and benefits as part of their efforts to constrain overall federal spending. According to Hartman, this approach fails to deal with the real problems of the federal compensation system. On the one hand, he writes, relatively low entry-level salaries hamper the recruitment of first-rate professionals—and encourage rapid promotions. On the other hand, the relatively low ceilings on salaries of career workers, in combination with the generous benefits offered by the federal retirement program have led most high-level civil servants to retire soon after becoming eligible. Unless something is done soon to modify the system, Hartman suggests, current practices could lead to a serious decline in the quality of the federal work force.

Hartman proposes a package of reforms that would address the problems in both pay scales and pension programs—reforms that are designed to reduce costs in the long run and to enhance the government's chances of attracting and retaining high-quality employees in the short run.

As to pay, Hartman suggests splitting the salary schedule into two separate tracks—one for clerical and technical personnel and the other for professional and administrative staff. Pay for entry-level and senior administrators would be raised to be more nearly competitive with private-sector salaries.

At the same time, under Hartman's proposals, the federal retirement system would be dramatically overhauled. Federal workers would be brought under social security and a special supplementary retirement program that would set up individual retirement accounts for the employees. These retirement accounts would be funded in part by the government (up to 7 percent of an employee's salary) and in part by employees themselves (up to 11 percent of salary). The benefits under this dual system would provide an adequate retirement income to federal personnel at less cost than the current retirement program.

Hartman, a former senior fellow in Economic Studies at Brookings, is now senior analyst for budget process at the Congressional Budget Office.



The Crisis of the Thrift Industry is Over

The Rescue of the Thrift Industry

Andrew S. Carron. 31 pages.
\$5.95 paper

THE THRIFT INDUSTRY in the United States approached collapse in 1982, according to Andrew S. Carron, "but the crisis is over" and the industry's future appears healthy. The crisis was resolved, says Carron, by a combination of lower market interest rates and landmark legislation.

In a 1982 study entitled *The Plight of the Thrift Institutions*, Carron, a senior fellow in Economic Studies at Brookings, predicted operating losses for the industry and a substantial consolidation of thrift institutions over the 1982-84 period. Carron's new staff paper confirms the validity of those earlier forecasts.

Although the federal government removed itself in 1982 from many aspects of price and service regulation in the thrift industry, Carron finds that "operating losses exceeded the record levels of the previous year, and the number of firms declined dramatically." The number of federally insured savings and loan associations fell from 4,002 in 1980 to 3,433 by the end of 1982; the number of mutual savings banks dropped from 463 to 424.

Carron anticipates that additional mergers will lead to an industry of 2,500 firms or less; however, he writes that lower interest rates and new government policies have arrested the operating losses and the erosion of net worth that thrift institutions had been experiencing.

In July, 1982, the Federal Reserve Board began implementing a monetary policy that would reduce market interest rates. By the end of the year the six-month Treasury bill rate fell to 8 percent from a previous level of 12 to 14 percent, and long-term interest rates declined as well. These lower interest rates, Carron indicates, "slowed the decline of the industry and lessened the drain on the [FSLIC and FDIC] deposit insurance funds, thereby ensuring the capacity of the existing system to cope with the ongoing problems."

The Garn-St. Germain Depository Institutions Act of 1982 also helped thrifts, according to Carron, by permitting "a fundamentally new structure for the industry as well as the means of transition to that new structure." The Garn-St. Germain legislation enhanced the regulatory powers of government agencies, lessened asset and liability restrictions on thrifts, and further reduced deposit rate controls. Regulatory reform has had a positive impact: "Savings and loan associations may now lend to a variety of borrowers on a short- or long-term basis; they can raise funds through new market rate deposit instruments; and changes in accounting now permit firms to calculate their exposure to interest rate risks." In addition, alternative mortgage loan instruments and the ability to deal in futures and options help the industry to avoid the difficulties of the past.

Carron closes on a cautionary note; although the thrift industry has been rescued, he writes, "repercussions from the events of the past few years will continue to be felt," with mergers continuing and some firms requiring close supervision for as long as ten years.

Brookings Council

BROOKINGS HAS LAUNCHED a major new program—the Brookings Council—for individuals who have provided significant support to Brookings and for leaders of the Institution's major corporate sponsors. The Council is chaired by Lloyd N. Cutler of the Board of Trustees. Members of the Council will be invited to participate in special off-the-record discussions of major public policy issues with Brookings scholars and top government officials.

In May, a preliminary Council event was held in conjunction with the release of Brookings' annual review of the budget, *Setting National Priorities*. Senator Dan Quayle and Representative Leon Panetta led a discussion of federal budget issues and their relationship to the performance of the economy.

The first full Council gathering will be held in January, 1984, and will focus on the president's State of the Union address. Brookings scholars and administration officials will join Council members for an in-depth discussion of the major issues raised in the president's speech. Other Council events—including regional seminars—will be scheduled later in the year.

A list of the current Council membership may be found on the inside back cover of this issue of *The Review*.



top: Lloyd N. Cutler, chairman of the Brookings Council; John J. Creedon, president of Metropolitan Life Insurance Co.; and Joseph A. Pechman of Brookings.

left: Rep. Leon Panetta; Louis W. Cabot, chairman of the board of Cabot Corp.; and Alice Rivlin of Brookings.

above: Sen. Dan Quayle; Panetta; and Bruce K. MacLaury, president of Brookings.



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right: Howard Swearer, president of Brown University; Pechman; Eugene Eidenberg, vice president of MCI Telecommunications Corp.; and A. Lee Fritschler of Brookings.



left: Charles E. Walker, president of Walker Associates; Wilbur F. Monroe, president of Monroe Associates; J. Woodward Redmond, senior partner of J.W. Redmond & Co.; and Edward Bernstein, guest scholar at Brookings.

above: Cabot; Dr. John Lossing; Walker; Breene Kerr, president of Kerr Consolidated; and Roger D. Semerad, executive vice president of Brookings.

Conference on U.S.–Japan Economic Relations

ON APRIL 28, Brookings cosponsored, with the National Institute for Research Advancement in Tokyo and the U.S.–Japan Foundation, a conference on “The Future Course of U.S.–Japanese Economic Relations.” Organized by Edward R. Fried and Philip H. Trezise, both senior fellows in the Foreign Policy Studies program at Brookings, the conference focused on the connections between trade flows and financial markets and the impact of these connections on economic relations between the U.S. and Japan.

Each topic on the conference agenda was addressed by a pair of speakers, one from each of the two countries. Speakers from the United States included Senator John

C. Danforth; Anthony Solomon, president of the Federal Reserve Bank of New York; Henry Owen, former U.S. ambassador-at-large for economic summits; and Professor Ronald I. McKinnon of Stanford University. Speakers from Japan included Yotaro Kobayashi, president of Fuji-Xerox; Nobuniko Ushiba, former Japanese ambassador to the United States; Michiya Matsukawa, former vice minister of finance; and Masuru Yoshitomi of the Economic Planning Agency. William Niskanen, a member of the Council of Economic Advisors, delivered a luncheon address.

The proceedings of the conference, edited by Fried and Trezise, will be published later this fall.

left to right: Nobuniko Ushiba, Edward R. Fried, and Henry Owen.

Yotaro Kobayashi.



U.S.–Japan luncheon at Brookings.



Corporate Executives Confer with Brookings Scholars

ON JULY 7, seventeen members of the New York Public Issues Group—made up of corporate managers involved in corporate planning, public affairs, and government relations—met at Brookings with senior fellows Martin Neil Baily and Robert Z. Lawrence. The discussion centered on trends in U.S. productivity, technological development, and competitiveness in international trade.

The meeting was part of the Institution's ongoing effort to create new channels of communication between the practical scholars at Brookings and the men and women who run major corporations. It is evident from continuing increases in corporate financial support for Brookings that more and more business leaders are coming to view the Institution as a national resource and to appreciate the quality and usefulness of its research. In FY 83, corporate contributions to Brookings amounted to \$1,457,254, which represented a 26.5 percent increase over the total in FY 82.

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